Section One
Year in Review

Fiscal year (FY) 2014 saw improvement in the health of the U.S. banking system, as the aftermaths of the financial crisis of 2007–2008 continued to ease and an expanding economy provided new opportunities for banks to lend and grow. It was also a year in which the nation’s financial regulators continued to make progress implementing Dodd–Frank, which provided new tools to address risk and promote financial stability.

Overall, OCC-supervised banks and savings associations achieved noteworthy gains in 2014. In aggregate, these banks logged improvement in loan growth, net income, and asset quality, as the economy rebounded and unemployment trended downward. Significantly, community banks—generally defined as banks with total assets under $1 billion—saw better performance than in previous post-crisis years, demonstrating a resilience that reflects the important role these institutions play in the country’s economic life. The OCC reaffirmed its commitment to the vitality of community banking in 2014 in ways that are discussed later in this report.²

Beyond its accomplishments in connection with Dodd–Frank regulatory mandates, the OCC used its independent authority to promote more effective bank supervision. Efforts to achieve that goal included addressing rising operational challenges, such as cyber threats and third-party relationship risk management, and reassessing and revising the agency’s own supervisory strategies and techniques. The agency’s long-standing commitment to self-improvement has helped it acquire and retain its reputation as a global leader in supervising financial institutions.

Changing Complexion of Risk in the Federal Banking System

Bank supervision as carried out by the OCC comprises three distinct activities. The OCC licenses entry into the federal banking system and oversees the system’s corporate structure. The agency regulates by developing, implementing, and enforcing rules that govern banks’ conduct and activities. And the agency examines in accordance with the legal requirement that all banks receive a full-scope, on-site examination at least once during every 12-month period.³ The largest banks have teams of full-time, dedicated examiners whose job is to provide continuous supervision of all facets of the banks’ operations.

OCC examinations provide a detailed assessment of a bank’s financial performance since its last examination and the quality of its current management. Examinations also help the OCC develop a better sense of the industry’s direction and where potential threats to the industry’s safety and soundness may lie. When analyzed and synthesized with data from other sources, OCC examination findings form an important part of the broader picture of risk throughout the banking system. This information helps OCC-supervised banks identify areas of concern and adjust their business strategies accordingly.

One way the OCC disseminates this information and provides guidance is through annual and semiannual publications such as the Survey of Credit Underwriting Practices, the interagency Shared National Credits

² See section 2 of this report for a detailed review of the condition of the federal banking system.

³ The OCC may extend this requirement to 18 months if (a) a bank has total assets of less than $500 million; (b) it is well capitalized; (c) its previous examination assigned a rating of 1 or 2 for management and a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System; (d) it has not changed hands during the previous 12 months; and (e) it is not subject to a formal enforcement proceeding. See the “Bank Supervision Process” booklet of the Comptroller’s Handbook, September 2007, pp. 12–13. Unless otherwise noted, all documents cited in this report can be found on the “About the OCC,” “News and Issuances,” or “Publications” pages at www.occ.gov.
The discussion between former U.S. senator Christopher Dodd, center, and former congressman Barney Frank, right, was one of the highlights of the OCC–Boston University conference. OCC Senior Deputy Comptroller and Chief Counsel Amy Friend moderated the discussion.

Culminating a year of reflection on the agency’s 150-year history, a March 2014 conference cosponsored by the OCC and the Boston University Center for Finance, Law, and Policy looked to the future of banking and bank supervision. More than 300 attendees heard Comptroller Curry, FDIC Vice Chairman Thomas Hoenig, Financial Services Roundtable Chief Executive Officer Tim Pawlenty, and other distinguished presenters discuss the evolving nature of risk and how the changing regulatory environment is likely to affect banks’ ability to compete and serve their customers in the coming years.

Among the conference highlights was the discussion between former U.S. senator Christopher Dodd and former congressman Barney Frank on the landmark legislation that bears their names. OCC Senior Deputy Comptroller and Chief Counsel Amy Friend, who played an important role in shaping the Dodd–Frank legislation in her capacity as Chief Counsel to the U.S. Senate Committee on Banking, Housing, and Urban Affairs, moderated the discussion. Friend, Dodd, and Frank discussed the law’s development and enactment, assessed its accomplishments to date, and offered their thoughts on what remains to be done to prevent another financial crisis, protect consumers, and create a sound economic foundation to grow jobs and increase productivity.

The January 2014 survey covered 86 banks with assets of $3 billion or more for the 18-month period ending on June 30, 2013. Examiners were queried on retail and commercial loan products that represented 2 percent or more of each bank’s total loan portfolio. The survey covered loans totaling about $4.5 trillion.4

The survey reflected a continuation of the trend toward easing underwriting standards noted in previous years’ surveys. Easing standards in commercial loan products tended to take the form of more aggressive pricing and reduced collateral requirements and debt service

requirements to protect lenders. Loosening of loan covenants that typically require commercial borrowers to meet certain performance thresholds to continue drawing on their lines of credit also was noted. In the retail category, banks eased collateral requirements, pricing, and debt service requirements.

Risk management has been a major point of emphasis in OCC supervision for many years, and the agency reiterated and reinforced this priority in 2014. Examiners expect that credit risk will continue to increase in 2015, reflecting easing underwriting standards, strong competition for borrowers, and the uncertain state of the economy. The OCC will continue to review banks’ risk profiles to ensure that growth does not come at the expense of safety and soundness.

In the annual SNC review, examiners from the OCC, the Board of Governors of the Federal Reserve System (Federal Reserve Board), and the FDIC jointly focus on the quality of an important subset of bank loans: large syndicated credits in which multiple lenders participate. The 2014 review included examination of $975 billion in credit commitments covering 28.7 percent of the $3.39 trillion SNC portfolio.

A large share of this portfolio, and an even larger share of its criticized assets, was in the form of leveraged loans—loans that result in the borrower having debt that significantly exceeds industry norms. These loans, which often are used to finance purchases of other companies, offer lenders more attractive returns, in the form of fees and higher interest rates, than other loan products. They also, however, entail a higher degree of risk.

The 2014 SNC review focused significant attention on leveraged lending, including assessing the impact of the March 2013 Interagency Guidance on Leveraged Lending. The review found that risk in the overall SNC portfolio was centered in the leveraged portfolio, noting a criticized rate of 33.2 percent for leveraged loans, compared with 3.3 percent for the non-leveraged portfolio. While the high criticized rate for leveraged loans illustrates the risk inherent in this portfolio, the “pass” portion of the leveraged portfolio also carried more than the normal degree of risk, because these borrowers were considered to be more vulnerable to risk rating downgrades during an economic downturn. The analysis also showed that while borrower leverage was not the sole driver of an adverse rating classification, it was an important factor because of its influence on repayment capacity. Overall, the SNC review showed gaps between industry practices and supervisory expectations for safe and sound banking, as articulated in the guidance. In response to these findings, the OCC, the Federal Reserve Board, and the FDIC issued a leveraged lending supplement to the SNC review that identifies specific areas where institutions need to strengthen compliance with the March 2013 guidance.

The Semiannual Risk Perspective draws on the previously mentioned two reports, other financial data, and insights from the OCC’s ongoing supervisory activities to build a picture of risk conditions across OCC-supervised banks. It is a product of the OCC’s National Risk Committee (NRC), a cross-disciplinary group drawn from the ranks of senior officials who supervise banks of all sizes, as well as officials from the law, policy, accounting, and economics departments. The NRC meets quarterly and, among other things, issues guidance to examiners that provides perspective on industry trends and highlights risks and concerns that may require additional monitoring and supervisory attention.

The spring 2014 Semiannual Risk Perspective pointed to the three most salient threats to the future safety and soundness of the federal banking system. The first, as noted above, is credit risk, which the OCC judges to be low but rising, not only in syndicated leveraged lending but also in consumer products such as indirect auto loans. Banks make indirect auto loans through car dealerships, and it has become a matter of supervisory concern that loans with certain subprime characteristics reminiscent of the mortgage lending bubble, such as low down payments and extended terms, are being made in significant numbers.

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8 Criticized assets fall into one of four categories, from least impaired to most: special mention, substandard, doubtful, or loss.

In the Central District

For Rachel Rieniets, recent developments in technology and the economy have brought significant changes, to both the banks she examines and the way she does her job. What hasn’t changed is the importance of practicing firm and fair supervision in the context of a good working relationship, such as the one she has with the banks she supervises.

“Even if they get to be larger—and by ‘larger’ we mean still under $1 billion—they still really have community roots,” she said.

Ms. Rieniets, a commissioned National Bank Examiner (NBE), knows those communities well. A native Minnesotan, she has lived and worked in Alexandria, Minn., a town of about 11,000, since 2008. Over the past six years, she has traveled from her office in Alexandria (a satellite of the Minneapolis field office) to examinations at community banks all over Minnesota and parts of North Dakota.

She said improving economic conditions over the past year have eased some of the pressures on banks—and on bank examiners.

“We’re not seeing as many troubled institutions,” she said. “We’re seeing the volume of their classified problems improve. They’re able to work out deals. They’re able to actually start some loan growth again.”

Ms. Rieniets said that new technology has had a major impact on bank supervision. As the channels that banks use to interact with their customers, such as mobile and Internet banking, continue to evolve, “so does my ability to examine that and identify risks,” she said. “There’s more training that we all go through as examiners to keep up with the technology advances in the banking industry.”

While new banking technology has changed the risks examiners must identify, other developments have changed the supervisory process itself. Thanks to technology, it is no longer necessary for bankers to deliver reams of reports in hard copy to on-site examiners. Instead, Ms. Rieniets said, “bankers can just e-mail them to me using the OCC’s secure e-mail system and I can work from my office.”

That doesn’t mean examiners will stop visiting banks, however. “There’s always going to be certain work you have to do on-site,” she said. “Sometimes conversations with bank management are best held across the table looking eye to eye.”

Keeping an appropriate distance from the banks he or she examines is an important part of an examiner’s job, and the OCC regularly reassigns examiners to new banks to bring in a fresh perspective and help maintain that distance. It is also important, however, for examiners and bankers to maintain open lines of communication.

“We have really good working relationships with our bankers,” Ms. Rieniets said. “The banks I work with are more than comfortable calling me up and saying, ‘Rachel, we’ve heard about this product out there, we think it’s a really great idea. Where can we go to get additional information on it? What are the pluses and minuses that you’ve heard?’

“They’ll run those types of things by you first to avoid a violation of law or a regulation or an unsafe or unsound practice. That’s a lot easier for the bank than when we come on site and identify the practice as a problem. We will do so and then it’s much harder to unwind that transaction or practice.”

Even as the economy improves, loan growth has been sluggish in many parts of the country, leading some banks to turn to new products and services to build profits. But Ms. Rieniets said the banks in her area tend to be cautious, and the experience of the financial crisis has only strengthened their focus on the central business of making loans.

“There were a few lessons learned along the way. Our banks are really working to ensure concentration management—in other words, don’t put all your eggs in one basket. It’s much more on the front burner when they’re starting to write the strategic plan or look for loan growth.”

As dedicated as she is to her job, Ms. Rieniets prizes the work-life balance that the OCC provides. “Too much time away from home is always bad, but sometimes getting away for a little bit is good,” she said. “You’ve got to walk that fine line, and that’s something every examiner has to define for themselves.”
Another source of credit-risk-related concern has been with home equity lines of credit (HELOC) nearing their end-of-draw periods, when the principal amount of the HELOC must begin to be repaid. At that time, loans may reset to an amortizing payment or reach a balloon maturity, potentially resulting in higher monthly payments. While most borrowers in that situation continue to meet their contractual obligations, some find it difficult to make higher payments or to refinance their existing loans because of changes in their financial circumstances or declines in property values. In guidance released in July, the OCC and other federal financial regulatory agencies encouraged financial institutions to communicate clearly and effectively with borrowers about pending resets. The guidance also provided broad principles for banks to follow in managing risk as HELOCs reach their end-of-draw periods.10

The Semiannual Risk Perspective also focuses on strategic risk, which can arise when banks execute a change in strategic direction or from flaws in their business models and practices. A rising appetite for risk in a highly competitive marketplace can lead banks to expand into products and markets in which they lack adequate expertise. Banks that overreach in their bid to reduce overhead and back-office expenses may cut into critical risk management capabilities. Banks that do not devote adequate attention to succession planning and employee retention could find themselves at critical moments without essential leadership and expertise. OCC examiners emphasize the crucial role that bank boards of directors and senior managers must play in overseeing the adequacy of banks’ strategic planning and execution.

Finally, there is operational risk, which has been one of the OCC’s foremost concerns since the financial crisis demonstrated how lapses in risk management, internal audit, and corporate governance erode safety and soundness. Since that time, the OCC has taken action to address the following areas of operational concern.

**Third-Party Relationships**

In an increasingly interconnected world, no bank is entirely self-sufficient. Even the largest banks work in various capacities with outside vendors, which may supply retail system products, specialized support functions, or other services. Smaller banks, with their limited resources, typically find it more cost effective to contract with a third-party provider for such critical services as data processing and information security. While banks can gain efficiencies and expertise by outsourcing, this also exposes them to vulnerabilities in the vendors’ systems—and in the systems of any outside parties with which those vendors do business—in addition to their own.

Banks that work with third parties remain ultimately responsible for the products and services provided by them or under their names. The OCC has taken enforcement actions in recent years against agency-supervised institutions for legal violations committed by third parties that the banks hired to perform tasks such as telemarketing or debt collection. The OCC requires that banks establish and maintain effective third-party risk management programs.11

The OCC continued to focus on third-party risk in FY 2014. In October 2013, the agency issued updated guidance designed, as Comptroller Curry said, to provide “more comprehensive instruction for banks to ensure these relationships and activities are conducted in a safe and sound manner.”12 Among other things, the guidance instructs banks to adopt an effective third-party risk management process that follows a continuous life cycle for all third-party relationships,

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11 The Bank Service Company Act of 1962 and subsequent legislation gave regulators statutory authority to supervise third-party servicers of regulated financial institutions. That function is largely carried out on an interagency basis and coordinated through the FFIEC.

and to have risk management processes commensurate with the level and complexity of risk. The phases of that life cycle include planning, due diligence, third-party selection, contract negotiation, ongoing monitoring, and contingency planning for terminating the relationship, at which point banks may decide to switch providers, discontinue the activity, or bring it fully in-house.13

**Cybersecurity**

Efforts to safeguard the security of bank information systems and data remained one of the OCC’s areas of highest concern in 2014.

Banks have long been a target for electronic attacks. Hackers may have a number of motivations for breaching bank systems, including fraud, political activism, and intent to undermine public confidence in the U.S. financial system. New and more sophisticated threats surface almost daily and have affected a number of organizations in various industries. For example, attacks involving retailers cost merchants and credit card issuers tens of millions of dollars in lost business and remediation costs, and raised concerns among consumers about the safety of Internet commerce and electronic banking. In addition, vulnerabilities requiring remediation continue to be identified, such as the OpenSSL “Heartbleed” and the Bash “Shellshock” bugs that place financial institutions, their third parties, and customers at risk.

The largest banks have many employees dedicated to combating cyber threats. Many community banks, however, often rely on third-party relationships for cybersecurity. As cyber criminals seek the easiest access point into the financial system, the OCC emphasizes the need for community banks to be vigilant against attacks on their systems.14

Meeting the challenge of cybersecurity continues to require leadership on the part of industry executives, government officials, and financial regulators. As chairman of the FFIEC, Comptroller Curry spearheaded an interagency effort to raise public awareness, assist regulated financial institutions in understanding and managing the threats they face, disseminate best practices, and promote compliance with relevant regulatory requirements.15 In June 2014, the FFIEC launched a Web page that serves as a central repository for statements, alerts, and other related resources. An FFIEC webinar, *Executive Leadership of Cybersecurity: What Today’s CEOs Need to Know About the Threats They Don’t See*, was held in May.16

**Bank Secrecy Act**

Violations of the BSA/AML laws can be extremely costly for banks and may allow money launderers, drug traffickers, and other criminals to gain access to the banking system. Failure to maintain effective BSA compliance programs can also be exploited by terrorist groups and can harm national security. In 2014, the OCC took several enforcement actions against banks that failed to maintain effective BSA/AML programs and file complete, timely, and accurate suspicious activity reports (SAR). Among those actions was a $350 million civil money penalty (CMP) against three affiliated banks following a 2013 cease-and-desist order in which the banks were ordered to correct deficiencies in their compliance programs. The OCC also collaborated on BSA enforcement-related activities with other federal agencies and law enforcement entities such as the Financial Crimes Enforcement Network (FinCEN).17

In 2014, however, the number of BSA-related enforcement actions declined overall, and, in fact, the

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Karen Pham grew up thousands of miles from her parents’ native Vietnam. They had left the country as refugees from poverty, violence, and political repression. Settling in the United States, they owned a small business, and they instilled in their youngest daughter a strong work ethic and a desire to achieve.

“I’m proud to work for the OCC,” said Ms. Pham, a native of Los Angeles, Calif. “It means a lot to my parents that the opportunities and the education they worked so hard to provide have led to this career, where my actions can make an impact for the better.”

Ms. Pham, an NBE in Santa Ana, Calif., brings a keen sense of civic duty to her work at the OCC. She joined the agency in 2006, after majoring in business administration at the University of Southern California. “A good examiner has to have a high level of skill and judgment—in banking, communications, and organization—and also a lot of adaptability,” she said. “I’m constantly challenged to scrutinize myself and reassess my assumptions so that I can do the best possible job.”

While examining more than 50 banks in her career, Ms. Pham has encountered many types of problem banks. She recalled one bank that underwrote poor-quality commercial loans during the run-up to the financial crisis, resulting in financial losses when the economy slipped into recession.

In dealing with that bank and its challenges, Ms. Pham drew on her diverse experience to develop an appropriate supervisory response. This included requiring the bank to establish a strong risk management framework, including better monitoring of its riskiest customers. The bank also reduced its troubled assets, boosted deposits from local customers, and strengthened its information technology program against disasters and cyber attacks.

“In spite of all the time and hard work it involved, the bank understood that it was better off for it,” Ms. Pham said.

At another bank, Ms. Pham used her financial and teamwork skills to address an excessive concentration of assets. The bank—through its subsidiaries—acquired investments whose total value exceeded the OCC’s lending limit of 15 percent of the bank’s capital and surplus. “The bank was reluctant to sell these investments,” she said. “For a few years, it moved the assets around among itself, its subsidiaries, and its holding company, but didn’t really sell anything. We had to demand a clear strategy and action plan.” Only then did the bank take steps to correct the problem.

“Good communications made the difference with that bank,” said Ms. Pham, “and good communication is essential to bank examining in general.” She notes that examiners must speak to many kinds of audiences, including loan officers, bank managers, and board directors with no background in banking. OCC reports of examination must clearly explain the condition of each bank. Likewise, OCC memorandums issued to banks and cease-and-desist orders must clearly describe what a bank must do to improve.

Well-organized messages are important, and so is a well-planned exam schedule. “It’s important to know how many examiners to assign to each exam,” said Ms. Pham. “And, depending on the complexity of the institution, we may also bring in specialists in credit risk or information technology, for example. We have to consider the examiners’ travel needs and the amount of off-site supervision conducted from our offices. It’s important to work efficiently, while also being as effective as possible.”

Ms. Pham prides herself on her broad perspective as a veteran examiner-in-charge. “I’ve examined banks with a few million dollars in assets, and banks with tens of billions,” she said. “I try to be a self-starter, use my creativity, and understand the bank and who its customers are. It’s gratifying when those efforts bring about positive changes at banks. In the end, those changes benefit all users of the financial system.”
vast majority of OCC-supervised banks were found to have programs in place that meet the requirements of the BSA. OCC examiners are increasingly seeing a stronger commitment from senior bank management to resource these functions adequately, empower and pay BSA staff accordingly, and, when mistakes—inadvertent or deliberate—occur, hold the responsible party or parties accountable. While these are positive developments, BSA/AML risk remains high and the OCC and the banking industry must remain vigilant in this area.  

**Consumer Protection**

In Dodd–Frank, the Consumer Financial Protection Bureau (CFPB) received exclusive authority to write regulations implementing specified federal consumer financial laws, as well as authority to examine banks with more than $10 billion in total assets for compliance with those laws. For banks with $10 billion or less in total assets, the OCC and the other prudential banking regulators retained consumer compliance examination and supervision authority to enforce CFPB-authored regulations.

These legislative changes have not diminished the OCC’s commitment to consumer protection. The agency continues to enforce those laws with respect to which the authority did not transfer to the CFPB, including section 5 of the Federal Trade Commission Act, the CRA, and the Servicemembers Civil Relief Act (SCRA). OCC supervision and enforcement staff also work closely with their CFPB counterparts on matters affecting OCC-regulated entities, and the OCC consults with the CFPB on its rulemaking initiatives, as provided for in Dodd–Frank. As it has always done, the OCC considers a bank’s consumer compliance record in the process of evaluating merger and acquisition applications and in the performance evaluations that lead to a CRA rating. A bank’s consumer compliance record also tells much about the strength of the bank’s corporate governance and culture. “There is no neat dividing line between consumer compliance and safety and soundness issues,” Comptroller Curry observed. “If an institution has a compliance issue, they are certain to have underlying risk management issues.”

In 2000, the OCC became the first government agency to use the authority of section 5 of the Federal Trade Commission Act to take enforcement action against a bank found to have engaged in unfair and deceptive consumer acts or practices. Since then, the agency has taken dozens of enforcement actions, resulting in hundreds of millions of dollars in CMPs and restitution paid to consumers victimized by illegal practices.

The OCC used this authority in 2014 to stop unfair and deceptive add-on consumer products, which some banks offered through marketing agreements with third-party vendors. Banks were cited for offering debt cancellation products that did not always cover the consumer’s minimum monthly loan payment, as promised, and for identity theft protection products that did not deliver the promised benefits. Because these cases involved third parties, the OCC’s consent orders also required the cited banks to develop and submit risk management plans for add-on consumer products marketed or sold by the banks or their vendors.

The OCC retains its authority for ensuring compliance with the SCRA. This law provides a range of legal and financial protections to active duty military members, reservists, and, to a lesser degree, National Guard members. The SCRA’s provisions include foreclosure and eviction protection and interest rate caps on certain types of consumer debt. When SCRA violations occur in OCC-supervised banks, the agency takes decisive action, including requiring the bank to pay remediation and correct the operational deficiencies that led to the problem.

With respect to small-dollar lending, the OCC has encouraged banks to make such products available

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on more reasonable terms and subject to closer supervision. With that goal in mind, the OCC issued final guidance on deposit advance products, which are short-term loans repaid from the customer’s next direct deposit. The OCC’s guidance provides a regime of careful compliance and risk management standards to ensure that these products are safe for consumers as well as for the banks that offer them.\(^{22}\)

The OCC’s Customer Assistance Group (CAG) is another resource available to help bank customers. The group handles complaints and concerns related to applicable banking laws and regulations. In addition to providing informal consumer education on a variety of banking topics, the Customer Assistance Group facilitates communication between banks and their customers regarding individual disputes formally filed with the OCC.


**Community Reinvestment Act**

The CRA requires banks to meet their communities’ needs for financial products and services. OCC examiners evaluate banks’ CRA performance and assign ratings of “outstanding,” “satisfactory,” “needs to improve,” or, in the worst cases, “substantial noncompliance.” Most banks strive to achieve outstanding ratings, not only to enhance their public reputations but also because their business depends on the financial well-being of their customers and the communities they serve. Also, the OCC considers a bank’s record of CRA performance when reviewing that bank’s application to establish a branch, merge or consolidate with another insured depository institution, or relocate a main office or a branch.

The federal financial regulatory agencies make revisions to, refinements in, and clarification of CRA policy through Interagency Questions and Answers (Q&A), the most recent of which were issued in
November 2013.23 One of the issues addressed in these Q&As concerned the geographical scope of the products and services that qualify for CRA consideration. Banks are evaluated for CRA purposes based on their responsiveness to financial needs and opportunities in their assessment areas, defined as the areas in which a bank has its main office, branches, and deposit-taking automated teller machines, and the surrounding areas where the bank has originated or purchased a majority of its loans. The November 2013 Q&A affirms that CRA consideration is extended to community development activities conducted in a broader statewide or regional area that includes a bank’s assessment area, if the bank has been responsive to needs and opportunities within its assessment area. The OCC believes that this approach provides a more flexible standard for evaluating CRA performance and will stimulate banks to look outside their assessment areas for opportunities to lend and invest in rural communities.24 In 2014, the OCC processed 906 public welfare investments—those that provide capital for affordable housing, small business development, and other community needs—totaling $10.5 billion.

**Changing Regulatory Environment**

Acting on its own and in concert with other federal financial regulators, the OCC in 2014 made significant progress in fulfilling Dodd–Frank requirements and completing other rules intended to achieve the law’s broad objective of promoting transparency, financial stability, and market integrity.

**OCC–OTS Integration**

As described in the Annual Report in previous years, the OCC successfully completed the transfer of responsibility for the examination, supervision, and regulation of federal savings associations from the OTS to the OCC by the July 21, 2011 deadline set by Dodd–Frank.25 Since then, the OCC has worked toward the goal of greater supervisory uniformity for banks and federal savings associations. The OCC has undertaken a comprehensive, multiphase review of


Comptroller Curry testifies in February before the U.S. Senate Committee on Banking, Housing, and Urban Affairs on the OCC’s progress in implementing the provisions of Dodd–Frank.

OCC and OTS regulations to reduce regulatory burden and duplication, promote fairness in supervision, and create efficiencies for both types of institutions, consistent with safety and soundness. In May, the agency issued a final rule that integrated certain national bank and federal savings association rules issued on an interagency basis relating to consumer protection in insurance sales, BSA compliance, management interlocks, appraisals, disclosure and reporting of CRA-related agreements, and the Fair Credit Reporting Act.26 In June, the agency issued a proposal to integrate national bank and federal savings association rules related to corporate activities and transactions.27 And in September, the agency issued a final rule integrating its national bank and federal savings association rules relating to safety and soundness standards.28

**Volcker Rule**

Among the OCC’s important recent accomplishments was finalizing the rules implementing section 619 of Dodd–Frank, better known as the Volcker rule, together with the other federal banking agencies, the Securities and Exchange Commission, and the Commodities Futures Trading Commission.

The Volcker rule prohibits banks from engaging in proprietary trading and from owning, sponsoring, or having certain relationships with hedge funds or private equity funds. Section 619, however, permits banks to engage in related activities that preserve
market liquidity and allows banks to provide important client-oriented services, including market-making, underwriting, risk-mitigating hedging, and trading in government obligations.

On December 10, 2013, after reviewing more than 19,000 comment letters, the OCC and the other rule-writing agencies adopted joint final regulations implementing the requirements of section 619. The revisions adopted in the final rule addressed a number of concerns expressed by commenters. The final rule

- provides exemptions for certain activities, including market making-related activities, underwriting, risk-mitigating hedging, trading in government obligations, insurance company activities, and organizing and offering hedge funds and private equity funds.
- clarifies that certain activities are not prohibited, including acting as agent, broker, or custodian.
- scales compliance requirements based on the size of the bank and the scope of its activities. Larger banks must establish detailed compliance programs and their chief executive officers must attest to the OCC that the bank’s programs are reasonably designed to comply with the final regulations. Smaller banks engaged in a modest amount of Volcker rule-related activities are subject to a simplified compliance program.

The rule is to be implemented by covered institutions during a conformance period that runs through July 21, 2015.30

One of the major concerns expressed by community banks during the rulemaking process concerned the treatment of collateralized debt obligations backed by trust preferred securities (TruPS). Community banks pointed out that the proposed Volcker rule would have required them to divest of these investments, and, as a result, recognize an immediate write-down in their value, an outcome that would have been at odds with another Dodd–Frank provision that permitted favorable treatment for regulatory capital purposes for these instruments. The OCC and other rulemaking agencies issued clarifying questions and answers and later approved an interim final rule permitting banks to retain certain collateralized debt obligations backed by TruPS under specified circumstances.30

Swaps Margins

The Volcker rule is one of several Dodd–Frank provisions that aim to curb speculation in derivative products without interfering with the legitimate need for financial institutions to manage risk through their hedging activities. Dodd–Frank’s sections 731 and 764 require covered institutions to collect cash or collateral for swaps that are not routed through clearinghouses. In April 2011, federal financial regulatory agencies issued a proposed rule to establish margin requirements for swap dealers and major swap participants. Then, in September 2013, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions finalized their own agreements on how to treat these instruments, and U.S. regulators modified their proposed rule so that it conformed to both the new international standard and Dodd–Frank’s requirements.31

In September 2014, federal financial regulatory agencies released that rule for comment. The proposed rule would establish minimum margin requirements for swaps based on the relative risk of the counterparty and of the swap itself. The proposed rule specifically seeks to avoid unnecessarily burdening both nonfinancial entities that use swap contracts to hedge commercial costs and smaller financial companies whose activities do not pose a risk to the financial system. Although the comment period was still under way in FY 2014, the OCC has already seen improvement in the collateralization rates for industry derivative exposures.32


31 Testimony of Thomas J. Curry, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, September 9, 2014.

As banks in the competitive New York City metro area strive for growth and profitability, Kerry Ann Samuel works hard to help the community banks she examines manage the accompanying risks.

“We remind them to do due diligence and promote a strong risk culture. If they don’t, we warn them that things could spiral out of control,” she said.

As the Analyst for the Deputy Comptroller for Community Bank Supervision in the Northeastern District, Ms. Samuel supports the Deputy Comptroller in managing all 11 field offices and two satellite office locations in the district, acting as a bridge between OCC Headquarters and the field to communicate and apply agency policies. Before taking that job in October 2014, Ms. Samuel worked for five years as the Analyst for one of the Assistant Deputy Comptrollers in the New York field office. During this time, she supervised a portfolio of community banks and participated in examinations across the field office’s supervisory region, which comprises New York City, Long Island, New Jersey, and parts of upstate New York and Connecticut.

During her 12 years with the OCC as a field examiner, portfolio manager, and ADC Analyst, she repeatedly visited the banks in her portfolio. “We try to foster good communication with the bankers,” she said. “We hold outreach sessions at the district level, where bankers hear from OCC experts on hot topics like compliance, IT, and operational risk.” These sessions, which are also attended by senior OCC managers for the region, give bankers regular opportunities to ask questions and get up-to-date information about best practices and emerging risks.

Every quarter, portfolio managers review their respective banks. “We take this opportunity to touch base with bank management and discuss the banks’ performance,” she said. This is how the OCC provides “continuous supervision” of banks.

OCC examiners generally live in the same communities as the banks they supervise, and Ms. Samuel has lived in the New York City area for many years. Her familiarity with the broad and diverse area covered by the New York field office helps her engage with the bankers. “They know to reach out to us if they’re having difficulties,” Ms. Samuel said. “Bankers often call us to ask what we’re seeing in other banks” in regard to emerging risks and best practices. “We welcome those calls, because they foster good communication between the banks and the OCC.”

BankNet, the OCC’s secure Web site for communicating with and receiving information from banks, provides enormous value to bankers and examiners, she noted. The site has enabled more efficient information sharing between banks and the OCC. It allows banks to view statistics and trends at other OCC-supervised institutions. In the New York field office region, she said, at least one manager at every bank is signed up to use the service.

Ms. Samuel said one of the biggest concerns of bankers in her area has been strategic planning, particularly how to deploy capital and excess liquidity. Although this is a concern many businesses would like to have, problems can arise when banks get involved with unfamiliar new products and services to try to generate earnings.

Since the financial crisis, she said, “there hasn’t been as much demand for loan products, and banks are trying to come up with creative ways to generate earnings for shareholders. We encourage bankers to look at their underwriting standards, to talk to the board and collectively decide what the bank’s risk appetite is and whether it is compatible with new or expanded products and services.”

Cybersecurity is another major concern. “Cyber threats are as big a risk to small banks as they are to large ones,” Ms. Samuel said. “We talk to our banks repeatedly to remind them of new and ongoing threats and to encourage them to take appropriate testing and security measures.”

Ms. Samuel takes a lot of satisfaction in helping the banks she works with. “I enjoy working at the OCC because I truly believe in our mission,” she said. “In my early days on the job, my manager told me, ‘Don’t just identify the problems. When you do, try to come up with solutions.’ I try to do that every day.”
Stress Tests

Pursuant to section 165(i)(2) of Dodd–Frank, the federal banking agencies in October 2012 issued rules requiring banks with more than $10 billion in consolidated assets to conduct annual company-run stress tests to gauge how a bank’s risk may be amplified in adverse market or financial conditions, as occurred during the financial crisis. Banks with assets of $50 billion or more must also submit to stress tests conducted by their regulators.

In March, the banking agencies issued guidance for self-testing by midsize banks, defined as those with total assets between $10 billion and $50 billion. The guidance is designed to accommodate different risk profiles, sizes, business mixes, market footprints, and complexities. Consistent with this flexibility, the final guidance describes general supervisory expectations for stress tests and, where appropriate, provides examples of practices that are consistent with those expectations.33

Liquidity

While many factors contributed to the financial crisis, its proximate cause was a liquidity shortfall that left major banks with assets that could not be sold in time to meet the demand for cash from their customers and counterparties. To mitigate the risks that such shortfalls may pose to the financial system, the banking agencies in 2010 issued an “Interagency Statement on Funding and Liquidity Risk Management,” which summarizes the agencies’ supervisory expectations for banks’ liquidity risk management.34 Subsequently, the OCC, the Federal Reserve Board, and the FDIC took steps to issue a regulation that sets forth a quantitative standard addressing the liquidity risks of the largest U.S. banking organizations.

In November 2013, the OCC, the Federal Reserve Board, and the FDIC issued a proposed rule applicable to large, internationally active banking companies (those with $250 billion or more in total consolidated assets or $10 billion or more in on-balance-sheet foreign exposure) and to any consolidated bank or savings association subsidiary of one of those companies that have, at the bank level, total consolidated assets of $10 billion or more. The proposal required these banking companies to maintain high-quality liquid assets, for example, central bank reserves, government and government-sponsored enterprise securities, and corporate debt securities that could be converted easily and quickly into cash. The proposal called for these banking companies to hold such assets on each business day in an amount equal to or greater than their projected cash outflows less their projected cash inflows over a 30-day period. The ratio of a company’s high-quality liquid assets to its projected net cash outflow is referred to as its “liquidity coverage ratio.”35

In September 2014, the agencies issued a final rule, which will go into effect on January 1, 2015. It does not apply to community banks.36

Capital

As highlighted in the OCC’s 2013 Annual Report, the financial crisis made plain that all institutions needed stronger and higher-quality capital. In response, the OCC, the Federal Reserve Board, and the FDIC adopted a revised capital regime in 2013 that required banks to hold more and higher-quality capital and added a new, stricter leverage ratio requirement for large, internationally active banking organizations, known as the Basel III supplementary leverage ratio.37 Unlike the more broadly applicable leverage ratio, the supplementary leverage ratio adds off-balance-sheet exposures to the measure of total leverage exposure. The supplementary leverage ratio is a more demanding standard because large banking organizations often have significant off-balance-sheet exposures arising from different types of commitments, derivatives, and other activities.

Concurrent with the issuance of the revised capital regime, the OCC and other federal banking agencies proposed a rule to enhance the supplementary leverage ratio requirement for the largest, most systemically important U.S. banking organizations. Because the very largest banks can have an outsized impact on the entire financial system, it makes sense to require

35 See the OCC’s Annual Report Fiscal Year 2013, pp. 8-12, for a full discussion of the new capital regime.
that they hold higher levels of capital. After careful consideration of public comments, the federal banking agencies adopted a final rule in May 2014. It requires covered bank holding companies (those with $700 billion or more in total consolidated assets or $10 trillion or more in assets under custody) to maintain a leverage buffer greater than 2 percentage points above the minimum supplementary leverage ratio requirement of 3 percent, for a total of 5 percent, to avoid restrictions on capital distributions and discretionary bonus payments. In addition, the rule added a 6 percent supplementary leverage ratio threshold to the “well capitalized” category of the prompt corrective action regulations for large, interconnected U.S. banks.38 “This new leverage capital rule,” Comptroller Curry said, “will not only strengthen our largest and most systemically important financial institutions, but will serve to reassure markets in times of stress.”

In September 2014, the OCC and other federal banking agencies further strengthened the supplementary leverage ratio with revisions that more appropriately capture banking organizations’ potential exposures.39 In particular, the revisions contained in this final rule better capture leverage embedded in banks’ activities of buying and selling credit protection through credit derivatives. This action should further improve the OCC’s assessment of leverage at the largest banks that are most involved in the credit derivatives business.

The supplementary leverage ratio rulemakings, along with changes the agencies made in 2013 to the risk-based capital standards, will improve the resilience of the largest financial institutions and help maintain public confidence in their ability to weather future financial shocks. Importantly, the supplementary leverage ratio also places an additional cushion between those banks and both the FDIC insurance fund and the resolution mechanisms of the federal government. These capital rules, said Comptroller Curry, “will go a long way toward preventing future systemic breakdowns of the type that triggered the last financial crisis.”


### Heightened Standards for Corporate Governance and Risk Management

The financial crisis can be traced to failures of corporate governance and risk management systems. At some banks, boards of directors and senior managers did not sufficiently understand 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 downside risks. Inadequate and fragmented technology infrastructures hindered efforts to identify, measure, monitor, and control risk. Some of these banks’ risk cultures discouraged independent risk managers and audit and control personnel from asking tough questions about management’s plans and execution. While these problems existed to some extent at banks of all sizes, problems at the largest, most complex banks created the greatest potential threat to the stability of the financial system.

For these reasons, the OCC developed a set of “heightened expectations” to enhance supervision and strengthen the governance and risk management practices of large national banks. In September, the agency issued final guidelines refining and formalizing these standards and making them enforceable under the Code of Federal Regulations (12 CFR 30, appendix D). The heightened standards do not apply to community banks.40

As the center on his college football team, Bert Hopgood was responsible for helping his quarterback quickly identify and respond to risks on the field. Today, as an NBE in the OCC’s Southern District, he is in the business of making sure banks identify risks to their solvency.

Mr. Hopgood joined the OCC in the Little Rock, Ark., field office in January 2007, just months before the economy entered its protracted downturn. He participated in community bank examinations and acquired valuable experience dealing with problem banks with poor loan quality and, sometimes, significant losses. He looked for red flags such as high percentages of delinquent loans and excessive concentrations of lending.

He also analyzed how the banks managed those risks. “We look at how well risks are identified, measured, monitored, and controlled,” he said. “When a bank is in a troubled condition, the root cause is usually management-related. We look at whether bank management is proactive or reactive in dealing with risk. We monitor the bank’s strategic planning. If a bank plans to move into a new market, has it conducted proper research and due diligence? Is it setting reasonable growth goals and defined thresholds?”

Mr. Hopgood and his colleagues sometimes conduct horizontal examinations, which focus on a subset of assets across various institutions. These examinations help the OCC gain insight into how banks are dealing with specialized risks, insight that the agency is able to share with other banks.

In a recent horizontal exam, Mr. Hopgood found one bank that had six carryover loans from 2013 out of a total 80 paid-out agricultural loans. “A carryover is a loan that has not been paid off from the current year operations, as most agricultural loans are,” explained Mr. Hopgood. “The harvested crop is the security for the loan. When a carryover is identified, we typically start with a ‘substandard’ classification and discuss with the bankers any mitigating factors.

“We found the loan had carryover not because of poor management by the borrower but because of a temporary factor—bad weather,” Mr. Hopgood said. “A wet spring had delayed the planting and irrigation of the soybean crop. The loan classification remained ‘pass’ for several reasons: current crop projections reflected an adequate cash flow; the bank developed a prudent workout strategy with a reasonable amortization and appropriate loan-to-value ratio for the carryover; and there was a history of positive borrower performance.”

“The horizontal exam gave us a good picture of agricultural lending in Arkansas,” he added. “We were able to go deeper into a particular line of business, learned more about crops, weather, types of soil, and had a good exchange of information with the bankers.”

“We require our banks to be proactive about dealing with risk,” Mr. Hopgood said. “But we must be proactive ourselves and learn as much as we can about our banks and their customers. That knowledge makes us more effective in preventing the next financial crisis and keeping the whole system strong.”
The guidelines set out roles and responsibilities for front-line units, independent risk management, and internal audit—what the OCC refers to as the “three lines of defense” for banks. Those units must establish appropriate systems to identify, measure, monitor, and control risk taking. They must ensure that the boards of directors have enough information on their banks’ risk profiles and risk management practices to ensure that operational units do not exceed the board-approved enterprise risk appetite. If variances arise, the boards of directors would then have more meaningful data with which to pose a credible challenge to management.

Under the OCC’s heightened standards guidelines, large banks are required to develop risk appetite statements that define both quantitative and qualitative parameters for safe and sound operating environments. The guidelines require that these statements address the question of how the bank will assess and accept risks, articulating behavioral expectations that shape risk culture. In addition, it makes clear that quantitative limits on risk taking should be based on sound stress testing processes and other methods, taking into account banks’ earnings, capital, and liquidity positions.

The OCC’s heightened standards guidelines also address standards for boards of directors of large banks. The guidelines remind board members of their duty to exercise sound independent judgment and to actively oversee their banks’ compliance with safe and sound banking practices. The guidelines stipulate that each covered bank’s board have at least two independent members, that each bank must establish and maintain an ongoing training program for the independent board members, and that each bank conduct an annual self-assessment of the board’s effectiveness.41

Diversity

The OCC’s long-standing commitment to a diverse workforce was codified in Dodd–Frank’s section 342, which required the OCC to establish an Office of Minority and Women Inclusion (OMWI). This office is responsible for all OCC matters relating to diversity in management, employment, and business activities, and for developing standards to assess the diversity policies and practices of entities regulated by the OCC. Section 342 required each federal financial regulatory agency to establish an OMWI office and develop assessment standards.

In 2012, the OCC and five other federal financial regulatory agencies focused their efforts on developing the assessment standards. Agency representatives held roundtable discussions with a range of parties, including representatives from financial institutions, holding companies, and industry trade groups, to solicit input on assessment standards and to learn about the challenges and successes of current diversity programs and policies. The agencies also held roundtables with financial professionals, consumer advocates, and community representatives to gain a better understanding of issues facing minorities and women in employment and business contracting in the financial sector.

Information obtained from these discussions helped shape the proposed joint assessment standards released for comment in October 2013. These proposed standards covered four key areas:

- Organizational commitment to diversity and inclusion.
- Workforce profile and employment practices.
- Procurement and business practices and supplier diversity.
- Practices to promote transparency of organizational diversity and inclusion.

The agencies tailored the standards to account for a number of variables, including asset size, number of employees, governance structure, income, number of members or customers, contract volume, location, and community characteristics. The agencies also recognized that standards may need to change and evolve over time.42

The agencies collectively received more than 200 comments on the proposal from financial institutions, public interest organizations, trade associations, government officials, and other members of the public. The agencies are carefully considering these comments as they formulate the final standards.

**Stabilizing Housing Finance**

The financial crisis exposed problems in mortgage lending and gave rise to higher standards for mortgage lenders and related businesses. Dodd–Frank required lenders to certify that borrowers have the ability to repay their mortgages, held lenders liable for mortgages extended to unqualified borrowers, expanded protections for those holding “high-cost” mortgages (generally, borrowers with the lowest credit scores), and required clearer and more comprehensive disclosures. The law also required that issuers of securities backed by mortgages that did not meet these standards retain a financial interest in those securities.

At the same time, federal programs such as the Home Affordable Mortgage Program provided alternatives for homeowners who fell behind on their mortgage payments or whose outstanding mortgages exceeded their homes’ market value. Regulators imposed heavy penalties on lenders who misrepresented the quality of mortgage loans sold to investors or engaged in illegal or unethical foreclosure practices. Together, these actions aimed to restore integrity to mortgage lending, provide redress for affected consumers, and restore a healthier equilibrium between supply and demand in the nation’s housing markets.

These initiatives continued to bear fruit in FY 2014. The OCC’s quarterly reports on the performance of first mortgages recorded a rise in the percentage of mortgage loans that were current and performing, while the number of mortgages in the process of foreclosure dipped from 604,000 at the end of the third quarter of calendar year 2013 to 391,000 at the end of the second quarter of calendar year 2014. Between January 1, 2008, and March 31, 2014, servicers had implemented 3,525,000 loan modification agreements, helping thousands of Americans to avoid foreclosure and remain in their homes.43

In January 2013, the OCC released a status report on the Independent Foreclosure Review Settlement reached between regulators and the largest mortgage servicers. It showed that more than $3.3 billion had been disbursed to qualified borrowers by OCC-supervised servicers, and billions more had been provided in the form of foreclosure prevention assistance, including borrower counseling and education.44 Nonprofit organizations also played a key role in advising homeowners and would-be homeowners on obtaining mortgages and meeting the financial responsibilities of home ownership.45

A major concern has been whether, in making mortgage lending safer, the Dodd–Frank mandates would make mortgages more difficult to obtain for otherwise creditworthy borrowers. The OCC issued guidance throughout the fiscal year with a view to


45 Remarks by Thomas J. Curry, National Asian American Coalition, October 18, 2013.
making it possible for banks to continue making sound loans to potential homeowners.

First, in October 2013, the federal banking agencies issued guidance to reassure lenders that a decision to originate only mortgages that meet the standards for qualified mortgages would not lead to a presumption that the lender was in violation of fair lending rules, which make it illegal to discriminate in any aspect of a credit transaction based on characteristics that include race, religion, marital status, color, national origin, sex, and age.46

Second, in December, the agencies issued a statement saying that a residential mortgage loan would not be subject to regulatory criticism solely because it did not meet the higher Dodd–Frank standards. The OCC emphasized that such loans would continue to be evaluated on their merits, taking into account loan terms, borrower qualification standards, loan-to-value limits, and other traditional factors.47

Supervising Community Banks

Community banks and their employees play a crucial role in providing consumers and small businesses in communities across the nation with essential financial services and sources of credit that are critical to economic growth and job expansion. Community bankers offer hands-on counseling and credit products tailored to meet small businesses’ specific needs. Community bankers strengthen communities by helping them meet municipal finance needs and by actively participating in civic life. Community bankers deeply understand their local markets’ unique needs and tailor their bank products and services to meet those needs. The willingness and ability of community bankers to work with their customers through good times and bad is one reason local businesses rely on community banks. And it is one reason so many of these communities have thrived.

These advantages helped explain why well-managed community banks weathered the financial crisis and provided a steady source of credit to their communities. These advantages also help explain the considerable improvement in the overall condition of community banks since the crisis. The number of troubled institutions has declined significantly, capital has increased, asset-quality indicators are improving, and lending opportunities are rebounding. Indeed, community banks have experienced growth in most major loan categories and at a faster pace than that of the federal banking system as a whole.

Yet, community banks still face many challenges. Some community bankers express concern about the long-term viability of their business models and frustration that too much of their time and resources are spent trying to track and comply with an ever-expanding array of regulatory requirements. Economic recovery and job creation continue to lag in many regions and communities, and many community bankers face the challenge of finding profitable lending and investment opportunities without taking on undue credit or interest rate risk. Strategic risk is a concern for many community bankers as they search for sustainable ways to generate earnings in the current environment of prolonged low interest rates, increased competition, and rising compliance costs. In addition, although the volume and sophistication of

Since 2010, the OCC has made significant advances in building its capacity to deal with increasing levels of operational risk. As part of this effort, the agency in December 2012 appointed Valerie Abend to be Director and Senior Critical Infrastructure Officer. Reporting to the Deputy Comptroller for Operational Risk, Ms. Abend brings deep public and private sector experience to her position. Before joining the OCC, she was a Managing Director at BNY Mellon and served as a Deputy Assistant Secretary of the Treasury for Critical Infrastructure Protection and Compliance Policy.

Ms. Abend learned the importance of advance preparations for disaster first-hand when her family lost its home to Hurricane Andrew in 1992. She continues to emphasize that lesson in helping the agency and the banks it supervises contend with evolving cyber threats and other operational issues.

Ms. Abend is the Comptroller’s representative and inaugural chair of the FFIEC’s Cybersecurity and Critical Infrastructure Working Group. The group was formed at Comptroller Curry’s initiative to raise industry awareness of cybersecurity risks and act as a vehicle for interagency coordination and collaboration on cyber issues.

In 2014, staff members from the FFIEC agencies piloted new cybersecurity examination procedures at more than 500 community institutions to assess their level of preparedness to deal with evolving and increasing cybersecurity threats. The agencies are now evaluating the results of this exercise, which will help inform future supervisory policy, procedures, and examiner training.

It is essential that bankers understand cybersecurity risks and how their strategy and business decisions impact these risks over time. “By monitoring and managing the technologies they use, the products and services they offer, and their connections to third parties, employees, and customers,” said Ms. Abend, “banks can better understand their cybersecurity risk.”

The OCC is making a concerted effort to help community banks improve their awareness of cyber threats and risk mitigation tactics. “While community banks tend to rely more heavily on third-party service providers to manage their core systems, there are risks on both sides of these relationships,” she said. “It is important that community banks have the information they need to support their ongoing efforts to manage this risk.” To support this effort further, the FFIEC launched a cybersecurity Web site that provides a single resource for bankers seeking the latest supervisory news and information on the evolving cyber environment.

The OCC will continue to expand these efforts. After all, Ms. Abend said, “the threats to financial institutions are vast and growing in sophistication and volume. We need to identify and assess cyber risks, share information, and decide what guidance and alerts to issue.” Ms. Abend will be a leading participant in these efforts.
cyber threats continue to challenge banks of all sizes, community banks must be especially vigilant to the risk posed by third-party providers, on which they tend to be especially dependent.

Given the importance of community banking to the United States, two-thirds of the OCC’s examination force is dedicated to supervising community banks. OCC examiners are part of the communities in which they work and are empowered to make most supervisory decisions at the local level. The entire agency works to support these examiners, providing them with easy access to licensing specialists, lawyers, compliance and information technology specialists, and a variety of other subject matter experts.48

The OCC has been especially sensitive to the views and concerns of community banks about regulatory burden in the rulemaking process. A number of the steps taken specifically to minimize that burden for community banks have already been noted in this Annual Report, notably the TruPS exception in the implementation of the Volcker rule, the supplementary leverage capital rules, and limits on the applicability of the new liquidity standards. To emphasize when a new supervisory initiative or rulemaking applies—or does not apply—to community banks, OCC bulletins now include a short section labeled “Note for Community Banks,” which tells community banks whether and to what extent the guidance may apply to them.

Moreover, the Economic Growth and Regulatory Paperwork Reduction Act of 1996 mandates that the OCC, the FDIC, and the Federal Reserve Board review their regulations every 10 years to identify, with the public’s help, outdated, unnecessary, or unduly burdensome regulations applicable to insured depository institutions. The current review got under way in June 2014, when the federal financial regulatory agencies published a Federal Register notice soliciting public comment on regulations relating to applications and reporting, powers and activities, and international operations. Other categories of regulations will be presented for comment in future Federal Register notices.49

The OCC continued to provide attention to two special types of community banks in 2014: mutual savings associations and minority-owned depository institutions. The agency’s responsibility for federal savings associations, including mutual savings associations, derives from the provision of Dodd–Frank under which the OCC absorbed the mission of the OTS. One way that the OCC fulfills that responsibility is through the Mutual Savings Association Advisory Committee, which provides information and advice to the OCC on conditions in that sector of the banking system and on regulatory changes that support the health and viability of those associations. The OCC’s committee comprises a diverse group of officers and directors of mutual savings associations of varying types, sizes, operating strategies, and geographic areas, as well as two representatives from federal savings associations in a mutual holding company structure.

OCC data presented to the committee at its July 2014 meeting showed that, like other OCC-supervised community banks, federal mutual savings associations are generally well capitalized and have relatively few asset-quality problems. All federal savings associations operate under the lending restrictions in the Home Owners’ Loan Act, which encourages them to provide housing credit and limits the amount of commercial lending in which they may engage. If a federal savings association wishes to broaden its business strategy, for example, to embrace more of a mix of business loans and consumer credit, it must convert its charter to a national bank charter, which can be an expensive and time-consuming process. For a federal mutual savings association to convert to a national bank charter, it must first convert to a stock thrift. Comptroller Curry has suggested the need for legislation to modernize the mutual savings association charter and provide these institutions with greater flexibility to expand their businesses and serve their communities.50

Minority-owned depository institutions also face challenges. They provide financial services, including

48 Testimony of Toney Bland, Senior Deputy Comptroller for Midsize and Community Bank Supervision, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, September 16, 2014.
depository services and small business lending, to communities that may lack other sound financial options. Partly for those reasons, federal financial regulatory agencies are required by law to give minority-owned depository institutions special support.

OCC support has come in several forms. In 2013, the OCC adopted a policy change that allows minority banks to broaden their capital base with the help of non-minority investors. The OCC also formed the Minority Depository Institutions Advisory Committee, with representation from African-American, Asian-American, Native American, and Hispanic institutions, as well as from other banks and government agencies offering opportunities through partnerships with minority institutions. In addition, the OCC maintained an active outreach program to minority bankers, through regular supervisory channels and executive-level initiatives facilitated by the OCC’s Community Affairs Department and External Outreach and Minority Affairs Department. The OCC provided technical training, such as the 2014 workshop on cybersecurity, which was specifically designed for the leaders of minority institutions.

Toward a Better OCC

Throughout 2014, the OCC advanced initiatives designed to preserve and enhance the agency’s status as a preeminent bank supervisor. The agency did so, in part, by using lessons of the financial crisis to identify necessary improvements. The OCC’s Annual Report Fiscal Year 2013 described the eight key elements of the agency’s strategic initiatives: aligning, supervising, leading, funding, connecting, engaging, messaging, and assessing. Those initiatives yielded significant accomplishments in 2014:

- Adoption of an automated testing and assessment process to expedite the evaluation and hiring of new examiners.
- Improvements in internal communications.
- A more formal approach to succession planning.
- A streamlined process for sharing examination findings with other bank regulatory agencies.
- Improvements in supervisory analytics.

In addition, the OCC conducted a comprehensive review of the agency’s approach to supervising large and midsize banks. The review was conducted by an independent, international, peer review team of bank supervisors from countries whose banks demonstrated particular resilience during the financial crisis. Jonathan Fiechter, a distinguished U.S. regulator who served in senior-level positions at the OTS, the OCC, and the World Bank, headed the team, which delivered its report to the OCC in December 2013.52

Fiechter and his colleagues praised the OCC’s employees and the agency’s supervisory approach, and flagged several areas where the agency could improve. The peer review team recommended that the agency expand the role and number of lead experts who assess specific activities and risk areas across multiple banks in the agency’s large bank supervision program. The team recommended adopting a formal examiner rotation program to limit the time an examiner spends at any one bank. The team also recommended that the OCC improve the way it evaluates risk at specific banks. It suggested refinements in the interagency CAMELS supervisory rating system and the OCC’s Risk Assessment System.53 The team also offered ideas to improve employee recruitment and retention.54

In response, the OCC formed two cross-functional working groups, one to evaluate recommendations related to policy enhancement and the other related to process improvement. The groups developed draft project lists and implementation plans, which were distributed to all OCC employees for comment. The OCC issued approved plans in July 2014 and assigned the plans to working groups for implementation, which was under way as the fiscal year ended. Future issues of the OCC’s Annual Report will chronicle the agency’s progress in these important areas.


53 CAMELS is an interagency supervisory rating system used by the supervisory agencies to classify a bank’s overall condition. Examiners rate the bank’s capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk.

During his 12 years as a trust examiner with the state of Ohio, there was very little Greg McDougle had not seen and done. So when the OCC made him a job offer, he viewed it as an opportunity to move on and up—to take advantage of the agency’s outstanding training program, to travel, and to work in the largest and most complex banks. That was 15 years ago. Today, Mr. McDougle is an important member of the Large Bank team that supervises Cleveland-based KeyCorp, which holds nearly $90 billion in assets.

During those years, he said, the trust business has undergone significant change. What was once a largely local, hands-on, service-oriented line of business has become more centralized, automated, and complex. It has become more competitive, as nonbank providers vie with banks for a limited number of affluent customers. “Competition,” Mr. McDougle pointed out, “has meant new options and more efficient service delivery for trust customers.” But it has raised systemic risk, as trust officers find themselves venturing further onto the risk curve to generate returns and income.

As a result of these changes, the work of the trust examiner has also changed. Other examiners used to tease Mr. McDougle that there was only one regulation he needed to know and enforce: 12 CFR 9, “Fiduciary Activities of National Banks.” That was never true, of course: Each state has its own fiduciary and tax laws with which national banks with multistate operations have to comply. It is even less true today, with the growing complexity of financial products and the internationalization of capital markets. As Mr. McDougle explained, “trust examiners have to be expert in the nuances of the Bank Secrecy Act and money transfers, for example, just as they are in the mechanics of trust administration.”

It is an expression of the agency’s regard for Mr. McDougle that he was chosen to be a member of its Policy Enhancement Team. The OCC formed this team, along with a separate Process Improvement Team, to design, prioritize, and implement the changes recommended by the international peer review report delivered to the OCC in December 2013. Because of the likely impact of the peer review initiatives on large and midsize bank examiners, the OCC, in consultation with the National Treasury Employees Union, agreed to include several such examiners on each team to ensure that the field perspective is taken properly into account. Mr. McDougle was among those selected to provide that perspective.

In his work on the Policy Enhancement Team, he has taken a special interest in the initiative to improve the way the OCC defines matters requiring attention (MRA), how the agency trains its examiners to recognize them, and how it tracks the way banks address them. That initiative was already under way when the peer review report was delivered, but it gained momentum when the agency appointed a sub-group in July 2014 to develop a final policy, an MRA reference guide, and tracking rules.

The MRA and other peer review initiatives will undoubtedly change the way the OCC conducts its business and the way large and midsize bank examiners operate. That kind of change is often difficult. But Mr. McDougle believes that when all is said and done, these changes will result in a stronger OCC and a stronger federal banking system.