

Statement of  
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Comptroller of the Currency  
Before the  
Subcommittee on Financial Institutions  
Senate Committee on Banking, Housing, and Urban Affairs  
United States Senate  
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Chairman Johnson, Senator Crapo, and members of the Subcommittee, I am pleased to testify on the current condition of the national banking system, including trends in bank lending, asset quality, and problem banks. The OCC supervises over 1,600 national banks and federal branches, which constitute approximately 18 percent of all federally insured banks and thrifts, holding just over 61 percent of all bank and thrift assets. As described in my written statement, the OCC has separate supervisory programs for large, midsize, and community banks that are tailored to the unique challenges faced by each.

Today, I would like to focus on three key points. First, despite early signs of the recession ending, credit quality is continuing to worsen across almost all classes of assets in banks of almost every size. The strains on borrowers that first appeared in the housing sector have spread to other retail and commercial borrowers. For some credit portfolio segments, the rate of nonperforming loans is at or near historical highs. In many cases, this declining asset quality reflects risks that built up over time. While we are seeing some initial signs of improvement in some asset classes as the economy begins to

recover, it will take time for problem credits to work their way through the banking system, because credit losses often lag behind the return to economic growth.

Second, it is very important to keep in mind that the vast majority of national banks are strong and have the financial capacity to withstand declining asset quality. As I noted in testimony before the full Committee last year, we anticipated that credit quality would worsen and that banks would need to further strengthen their capital and loan loss reserves. Net capital levels in the national banking system have increased by more than \$186 billion over the last two years, and net increases to loan loss reserves have exceeded \$92 billion. While these increases have considerably strengthened national banks, we anticipate additional capital and reserves will be needed to absorb additional potential losses in banks' portfolios. In some cases that may not be possible, however, and as a result, there will continue to be a number of smaller institutions that are not likely to survive their mounting credit problems. In these cases we are working closely with the FDIC to ensure timely resolutions in a manner that is least disruptive to local communities.

Third, during this stressful period we are extremely mindful of the need to maintain a balanced approach in our supervision of national banks. We strive continually to ensure that our examiners are doing just that. We are encouraging banks to work constructively with borrowers who may be facing difficulties and to make new loans to creditworthy borrowers, although it is true that in today's weaker economic environment, credit demand among businesses and consumers has significantly declined. And we have repeatedly and strongly emphasized that examiners should not dictate loan terms or require banks to charge off loans simply due to declines in collateral values.

Balanced supervision, however, does not mean turning a blind eye to credit and market conditions, or simply allowing banks to forestall recognizing problems on the hope that markets or borrowers may turn around. As we have learned in our dealings with problem banks, a key factor in restoring a bank to health is ensuring that bank management realistically recognizes and addresses problems as they emerge, even as they work with struggling borrowers.

One area where national banks are stepping up efforts to work with distressed borrowers is in foreclosure prevention. Our most recent quarterly report on Mortgage Metrics shows that actions by national bank servicers to keep Americans in their homes rose by almost 22 percent in the second quarter. Notably, the percentage of modifications that reduced monthly principal and interest payments increased to more than 78 percent of all new modifications, up from about 54 percent the previous quarter. We view this as a positive development, since modifications that result in lower monthly payments are less likely to re-default.

While many challenges lie ahead, especially with regard to the significant decline in credit quality, I firmly believe that the collective measures that government officials, bank regulators, and many bankers have taken in recent months have put our financial system on a much more sound footing. The OCC is firmly committed to a balanced approach that encourages bankers to lend and to work with borrowers in a safe and sound manner, while recognizing and addressing problems on a timely basis.

Thank you.