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TESTIMONY OF
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Before the
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER PROTECTION

of the
COMMITTEE ON BANKING, HOUSING, & URBAN AFFAIRS

of the
U.S. SENATE

April 11, 2013

Statement required by 12 U.S.C. 250:
The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

I. Introduction

Chairman Brown, Ranking Member Toomey, and members of the Subcommittee, I welcome this opportunity to discuss the role of independent consultants in the Office of the Comptroller of the Currency's ("OCC") enforcement process. In its letter of invitation, the Subcommittee expressed interest in the OCC's use of enforcement actions to require regulated institutions to retain independent consultants, and the OCC's oversight of the independent consultants when they are required.

The OCC uses its supervisory and enforcement authorities to ensure that national banks and federal savings associations ("banks") operate in a safe and sound manner, provide non-discriminatory access to financial services, treat customers fairly, and comply with applicable laws and regulations. As described below, the OCC and the other federal banking agencies ("FBAs") have a broad range of supervisory and enforcement tools to achieve this purpose. The FBAs' powers include the power to require banks to take specific actions to address and correct violations of law and unsafe or unsound practices. Pursuant to this authority, the OCC may require banks to retain independent consultants to work with them to identify the underlying causes of the violation or unsafe or unsound practice and to facilitate their correction.

The OCC has used its enforcement authority to require banks to retain independent consultants in a significant number of cases and for a variety of purposes. For example, the agency has required banks to retain independent consultants to provide expertise needed to correct operational and management deficiencies; to comply with legal requirements, such as the Bank Secrecy Act ("BSA"); and to provide restitution for violations of consumer protection statutes. In these and other instances, the use of independent consultants provides banks with the additional knowledge, experience, and resources required to address deficiencies identified

through the supervisory process. While we have found the use of independent consultants useful in many circumstances, it can be particularly valuable for community banks, which may lack the necessary expertise and resources to correct the problem on their own. In such cases, the use of independent consultants is not only helpful, but necessary, to ensure that the bank takes the requisite corrective action to operate safely and soundly and in compliance with the law. The use of independent consultants does not, however, absolve bank management and the bank's board of directors of their responsibilities. In this regard, a bank's board of directors is responsible for ensuring that all needed corrective actions are identified and implemented.

Similarly, it is important to note that the independent consultants are not substitutes for the supervisory judgment of the OCC. The OCC retains sole responsibility for supervising the bank, including overseeing and assessing the bank's compliance with an enforcement action.

The use of independent consultants as part of the Independent Foreclosure Review ("IFR") differed substantially from the agency's normal practice in many significant ways. The breadth, scale, and scope of the reviews were unprecedented, as were the large number of institutions, independent consultants, and counsel involved in the process. The file reviews proved to be much more complex and challenging than we anticipated, and involved a number of decision points, all of which required substantial oversight by the OCC. In retrospect, it is clear that our approach under the IFR process did not serve the agency's objectives which were, first and foremost, to compensate borrowers in a timely manner for the financial harm they suffered from faulty foreclosure practices. Our failure to fully appreciate the breadth, scale, and complexity of the reviews and to define a comprehensive and effective project plan at the outset hampered the process.

While the use of independent consultants can be an effective supervisory tool, there are certainly lessons to be learned from our experience, and we believe we can improve the process going forward. To that end, we plan to draw on our recent experiences when requiring banks to retain independent consultants and to enhance our oversight of the consultants when they are utilized.

The Subcommittee's interest spans a broad range of topics. My testimony covers five key areas: 1) the OCC's authority to require the use of independent consultants; 2) the circumstances in which the OCC has ordered banks to engage independent consultants; 3) the OCC's oversight of independent consultants; 4) an overview of some of the significant results of the use of independent consultants; and 5) the future use of independent consultants in OCC enforcement actions.

II. The OCC's Enforcement Authority

The OCC's enforcement process is directly related to our supervision of banks. The OCC addresses operating deficiencies, violations of laws and regulations, and unsafe or unsound practices at banks through the use of supervisory actions and civil enforcement powers and tools. Our enforcement policy¹ is to address problems or weaknesses before they develop into more serious issues that adversely affect the bank's financial condition or its responsibilities to its customers. Once problems or weaknesses are identified and communicated to the bank, the bank's management and board of directors are expected to correct them promptly.

¹ OCC's Enforcement Action Policy, which was publicly released as OCC Bulletin 2011-37, provides for consistent and equitable enforcement standards for national banks and federal savings associations and describes the OCC's procedures for taking appropriate administrative enforcement actions in response to violations of laws, rules, regulations, final agency orders, and unsafe or unsound practices or conditions.

Banks are subject to comprehensive, ongoing supervision that enables examiners to identify problems early and obtain corrective action quickly. Because of our regular, and in some cases, continuous, on-site presence at banks, we have the ability in many cases to stop unsafe or unsound practices or violations of law without ever having to take an enforcement action. This approach permits most bank problems to be resolved through the OCC supervisory process.

When this normal supervisory process does not result in bank compliance with the law and the correction of unsafe or unsound practices, or circumstances otherwise warrant a heightened enforcement response, the OCC has a broad range of enforcement tools. Among those tools is the ability to take formal enforcement action. Section 8 of the Federal Deposit Insurance Act (“FDI Act”), 12 U.S.C. § 1818, gives the OCC the power to take formal enforcement actions to require the cessation of unsafe or unsound practices and ensure compliance with any law, rule, or regulation applicable to banks. For example, the OCC may issue a Formal Written Agreement or a Cease and Desist Order (“C&D”) requiring a bank to take actions necessary to correct or remedy the conditions resulting from a violation or unsafe or unsound practice. It is pursuant to this power that the OCC requires banks, when necessary, to retain consultants to provide independent expertise and resources to correct deficiencies.

III. OCC Use of Independent Consultants in Enforcement Actions

It has been a longstanding practice of the OCC in enforcement actions to require banks to engage independent consultants. The nature and expertise of such consultants may vary, depending on the particular issues facing the bank and have included, for example, certified public accountants, lawyers, financial consultants, and information technology specialists. From

2008 through 2012, the OCC required banks to retain independent consultants in approximately 190 of 600 formal enforcement actions. The majority of actions taken have involved operational and compliance deficiencies, primarily in community banks.

The OCC requires banks to retain independent consultants for a number of reasons. First, independent consultants have subject matter and process knowledge, and often have experience in dealing with similar situations. They can apply that knowledge and experience to focus on the supervisory issue, identify its scope, and work with bank personnel to correct the bank's conduct and to remedy the consequences of the violation or unsafe and unsound practice. Second, independent consultants can provide the resources necessary to carry out a task in a timely manner. Finally, independent consultants are, as the name suggests, independent from the activities being conducted. Thus, rather than having the bank review itself, the OCC may require the use of a third-party to exercise independent judgment in assessing the scope of the problem and the remedy. In all cases, however, the OCC retains the final decision in determining whether the bank's corrective actions are sufficient.

The OCC has long required banks to retain independent consultants to assist the bank in addressing significant management and operational deficiencies. For example, in a sizeable number of cases, when the OCC has supervisory concerns about bank management's ability to accurately assess the credit quality of a bank's portfolio, the OCC has ordered the bank to retain an independent consultant to review asset quality until such time as the bank implements an effective internal asset quality review system. In cases in which there is a question about the accuracy of a bank's books and records, the OCC has required banks to retain auditors to review those records, to assess their completeness and report on any deficiencies. The OCC has also ordered banks to retain independent consultants to perform annual reviews of methods used by

banks to establish an allowance for credit losses. The OCC has required similar engagements by bank management to address deficiencies in a variety of other circumstances involving real estate appraisals, compensation, internal controls, and information technology systems. The majority of these cases are concentrated in community bank enforcement actions and reflect the fact that those institutions often have the greatest need for the expertise and resources that an independent consultant can provide to the banks' efforts to address deficiencies.

More recently, in a substantial number of cases, the OCC has ordered banks of all sizes to retain independent consultants to address deficiencies in compliance with the BSA and anti-money laundering laws and regulations. These actions sometimes require the retention of an independent consultant to conduct a review of a bank's BSA staffing, risk assessment, and internal controls. The goal of such an engagement is to secure a thorough analysis of the responsibilities and competence of existing bank BSA staff; to assess the levels of risk to the bank given its account activity, customers, products, and the geographic areas in which it operates; and to review the adequacy of internal controls given the risks posed by the bank's profile. Based upon that analysis, the orders typically require the independent consultant to provide a report to bank management and the bank's board of directors that includes recommendations for improvements to the bank's BSA program to ensure future compliance with regulatory requirements.

In other instances, the OCC has required the engagement of an independent consultant to conduct a review of the adequacy of actions already taken by the bank pursuant to its BSA program. These "look-backs" involve reviews of filings made by a bank pursuant to the BSA requirements. For example, a number of orders issued by the OCC have required banks to retain independent consultants to review transaction activity to determine whether Suspicious Activity

Reports (“SARs”) need to be filed by the bank, whether SARs filed by the bank need to be corrected or amended to meet regulatory requirements, or whether additional SARs should be filed to reflect continuing suspicious activity. The OCC has ordered similar look-backs by independent consultants of a bank’s currency transaction reporting. Following these look-backs, OCC enforcement actions have required banks to amend or correct existing filings and make other filings as required for any previously unreported activity that falls within the regulatory requirements.

The OCC has also ordered banks to engage independent consultants in consumer-related enforcement actions. For example, in a number of actions to remedy significant consumer law violations, including violations of Section 5 of the Federal Trade Commission Act regarding unfair or deceptive practices, the OCC has ordered banks to engage independent consultants to identify affected consumers, to monitor payments to such consumers, and to provide written reports evaluating compliance with specific remedial provisions in the enforcement actions. Similarly, the OCC has mandated the retention of an independent consultant to assist banks in developing and implementing a restitution plan provided for in the action. Finally, the OCC has required the engagement of independent consultants with claims administration experience to assist in carrying out the payment of required restitution to customers harmed by unfair or unsafe or unsound practices.

In these and other engagements mandated by OCC enforcement actions, the independent consultants are providing expertise and resources to banks to promote compliance with regulatory obligations. The independent consultants are not playing a regulatory role. That is solely the province of the OCC.

IV. OCC Oversight of the Use of Independent Consultants in Enforcement Actions

The OCC oversees independent consultants in a number of ways. At the outset, the OCC can compel the bank to submit the independent consultant's qualifications to the OCC for prior review and non-objection permitting the agency to assess whether the independent consultant has the requisite expertise and resources. This determination is based upon the OCC's exercise of informed supervisory judgment given the particular circumstances of the bank and the deficiency that gave rise to the enforcement action. The OCC also considers the proposed consultant's existing and prior relationships with the bank and potential conflicts of interest to determine whether there is a reason to believe that the independent consultant should not be engaged by the bank.

In addition, prior to the engagement of the independent consultant, the OCC often reviews the engagement agreement to determine whether the scope of the work, the resources dedicated to the project, and the proposed timeline for completion are consistent with the intent of the enforcement action. If at any time the OCC determines that the scope of the engagement is not consistent with that intent, we can require the bank to modify or terminate the agreement.

Thereafter, the OCC oversees the consultant and the progress of the engagement through its supervisory authority over the bank. The types and frequency of interactions between the OCC, the bank, and the independent consultant depend upon the particular facts and circumstances covered by the enforcement action, the expertise and resources of bank management, and the nature of the independent consultant's engagement. For example, in some cases, the issue may be discrete and the independent consultant's role is limited to the remedial steps the bank must take to comply with the enforcement action. In such circumstances, the appropriate oversight may involve very limited interaction. In other cases, the seriousness of the

violation and its consequences may require more frequent interactions between the examiners, the bank, and the independent consultant, including periodic reports and meetings, to make certain that the engagement is proceeding properly and that the bank is taking the appropriate steps to correct the deficiency. If the OCC determines that is not the case, the OCC can direct the bank to take the actions necessary to put the process back on track.

At the conclusion of the engagement, the enforcement actions often require a report of the findings and recommendations by the independent consultant to the bank's board of directors and management that is also required to be provided to the OCC. This gives the OCC the opportunity to assess whether all matters described in the action were addressed. If not, the OCC can require additional work to be performed or, if necessary, direct the bank to retain a different independent consultant. In a number of instances, the enforcement action also calls for the bank to prepare a plan to address the findings of the independent consultant. Such plans are often made subject to OCC review and non-objection before they can be implemented allowing the OCC to determine whether the underlying violations or practices will be corrected and remediation will be appropriately undertaken by the bank as called for in the enforcement action. Finally, the OCC examines the results of this entire process to validate that the bank, working with the independent consultant, has addressed and corrected the violation or unsafe or unsound practice that formed the basis for the enforcement action.

The circumstances in which independent consultants were used under the IFR pursuant to the OCC's April 2011 Consent Orders, differed substantially from the typical use of independent consultants in OCC enforcement actions. The unprecedented breadth, scale, and scope of the reviews; the large number of institutions, independent consultants, and counsel involved in the process; and the complexity of the file reviews, which involved hundreds if not thousands of

decision points on each file, required substantial regulatory oversight by the OCC and the coordination of multiple independent consultants' efforts. This expanded oversight included the issuance of joint guidance with the Federal Reserve Board; examiner visitation to the work locations of each of the individual consultants involved in the IFR process; and daily communications among consultants, servicers, and OCC supervision staff throughout the entire IFR process.

V. Significant Results

The enforcement actions in which the OCC has required the retention and use of independent consultants have produced significant positive results in many cases, and the independent consultants that were retained played key roles in bringing about those results. For example, in consumer cases, the independent consultants were engaged to facilitate or ensure the payment by banks of hundreds of millions of dollars to consumers as a remedy for violations of consumer protection statutes.

Similarly, in BSA cases, the OCC's requirement that banks engage independent consultants to conduct look-backs has resulted in substantial additional filings of SARs and, in certain cases, supported the OCC's assessment of significant Civil Money Penalties in response to the identified systemic failures of the banks to meet their anti-money laundering obligations. Over the past ten years, these BSA look-backs have resulted in thousands of additional or amended SAR filings covering approximately \$23 billion in suspicious activity.

In all of these cases, the independent consultants, engaged by banks as a result of an OCC enforcement action, were instrumental in assisting the banks in addressing and correcting the underlying deficiencies and bringing about a successful supervisory outcome.

VI. Future Use of Independent Consultants

The use of independent consultants has generally served the agency well in promoting banks operating in a safe and sound manner and in compliance with law. Given the experience with the IFR, the OCC is currently evaluating its use of independent consultants and exploring ways to improve the process, particularly for situations involving significant consumer harm or law enforcement implications.

While the OCC believes its authority and use of independent consultants is generally appropriate, there is one area where we believe legislative action could be helpful. Under the current statutory scheme, the OCC faces significant jurisdictional obstacles if it seeks to take an enforcement action directly against an independent contractor.² A recent court decision has further elevated the standard for taking such enforcement actions.³ The OCC would welcome a legislative change in this area that would facilitate our ability to take enforcement actions directly against independent contractors that engage in wrongdoing. Such a legislative change would be useful not only with respect to the use of independent contractors in an enforcement context but also, and perhaps more importantly, in cases where a bank has chosen to outsource significant activities to an independent contractor.

² In order to take an enforcement action against an independent contractor, the OCC is required to prove that the contractor engaged in knowing or reckless misconduct that “caused or is likely to cause more than a minimal financial loss to, or a significant adverse effect on, the insured depository institution.” 12 U.S.C. §1813(u)(4).

³ In *Grant Thornton v. Office of the Comptroller of the Currency*, 514 F.3d 1328 (D.C. Cir. 2008), the court held that the OCC must prove that the contractor was involved in the “business of banking” to meet the statutory jurisdictional requirements. Despite the fact that Grant Thornton was retained by the bank as a result of an agreement with the OCC to engage a nationally recognized accounting firm to conduct an audit of the bank’s mortgage program and related records, the court held that the work performed by Grant Thornton did not fall within the business of banking and, therefore, the OCC had no jurisdiction to proceed.

VII. Conclusion

The OCC's longstanding practice to require banks to retain independent consultants to help them meet enforcement requirements has generally worked well. Through this practice, the OCC has caused banks to address effectively a variety of operating and management deficiencies, to come into compliance with laws, rules and regulations, and to operate in a safe and sound manner. Nonetheless, we believe there are lessons to be learned from both our recent experience and our many years of experience with independent consultants, and we are exploring ways to enhance the process.