

10:00 a.m., June 13, 2018

TESTIMONY OF

JOSEPH M. OTTING

COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

June 13, 2018

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 Hensarling, Ranking Member Waters, and members of the Committee, thank you for the invitation to testify today. I am pleased to have the opportunity to share my priorities as Comptroller of the Currency and my views on what can be done to promote economic growth and opportunity by reducing unnecessary regulatory burden on national banks and federal savings associations, the institutions that the Office of the Comptroller of the Currency (OCC) supervises. I also intend to work diligently to ensure that the institutions within the federal banking system operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. I am honored to serve as the 31st Comptroller of the Currency, alongside nearly 4,000 men and women who share a deep dedication to the agency's mission. During my tenure, I look forward to advancing financial institution regulation with a focus on promoting the long-term health of the institutions we supervise and improving their ability to serve their customers and meet their communities' needs. In my testimony today, I will share my views on the condition of the federal banking system, the risks facing that system, and my priorities as Comptroller of the Currency.

Before I turn to those topics, however, I want to congratulate Chairman Hensarling on his term as Chairman of this committee and thank him for his thoughtful leadership during the years that he has served in this role. Mr. Chairman, the nation will miss your voice and intellect, but I am confident we will continue to benefit from whatever the future holds for you. Through your statements over the past several years and in our personal discussions, it is clear that we share the view that the federal banking system is an engine for creating jobs and economic opportunity. Our nation's banks are a source of strength for the nation and vital to meeting the financial needs

of consumers and communities across the country, while it supports U.S. businesses and interests globally.

During this time of relative calm in the banking system, we have an important opportunity to review our approach to banking regulation and supervision. Under Chairman Hensarling's leadership, the committee's foundational work in passing H.R. 10, the Financial CHOICE Act, and other important legislation stimulated the dialogue that made possible the enactment of the Economic Growth, Regulatory Relief, and Consumer Protection Act, and significantly influenced its content. The "Economic Growth Act" reflects bipartisan, common sense changes that will make an important difference to community and midsize financial institutions and the customers who rely on them.

The Economic Growth Act contains a number of important, bipartisan provisions that will have a meaningful impact on OCC-regulated institutions. Those include provisions reducing the number of community banks and savings associations subject to the Volcker Rule; a simpler capital regime for highly capitalized community banks and savings associations; allowing qualifying banks under \$5 billion in assets to file a simplified call report; expanding eligibility for an 18-month exam cycle to well-managed and well-capitalized banks under \$3 billion in assets; exempting certain mortgage loans for properties located in rural areas from appraisal requirements; and adding greater financial protections for our military service members and veterans. The law also raises the thresholds for application of the Federal Reserve Board's enhanced prudential standards for bank holding companies to focus on the very largest companies, right-sizes stress testing requirements, and provides federal savings associations with less than \$20 billion in assets the flexibility to exercise the powers of national banks without

changing charters, an important improvement that reduced unnecessary regulatory burden as championed by Representatives Rothfus and Himes and suggested by the OCC.

The OCC will work closely and cooperatively with our fellow financial regulators to ensure that all of these important reforms are implemented quickly so that financial institutions can continue to create jobs and promote economic opportunity in a safe, sound, and fair manner.

II. Condition of the Federal Banking System

As of the end of the first quarter of this year, the federal banking system comprised approximately 1,325 national banks, federal savings associations and federal branches of foreign banks (banks) operating in the United States. These banks range in size from small community banks to the largest most globally active U.S. banks. Approximately 1,061 of these banks have less than \$1 billion in assets, while more than 60 have more than \$10 billion. Combined, these banks hold \$11.8 trillion or about 67 percent of all assets of U.S. commercial banks. These banks also manage almost \$51 trillion in assets held in custody or under fiduciary control, which amounts to 42 percent of all fiduciary and custodial assets in insured U.S. banks, savings associations, and national trust banks. The federal banking system holds two-thirds of credit card balances in the country, while holding or servicing almost half of all residential mortgages. Through their products and services, a majority of American families have one or more relationships with an OCC-regulated bank.

Because of the reach of the federal banking system and the essential role it plays in meeting the financial services needs of so many Americans, their businesses, and their communities, it is critical that the system operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with laws and regulations. That is the unique mission of the OCC.

The OCC employs nearly 4,000 people, two-thirds of whom are bank examiners, overseeing the federal banking system. The majority of those examiners are dedicated to the daily supervision of community banks and work in offices and banks across the nation.

Supervision by Risk

The OCC applies a supervision by risk approach to the banks the agency supervises. Supervision by risk focuses on assessing risk, identifying existing and emerging issues, evaluating the effectiveness of a bank's risk management systems in appropriately controlling risk, and ensuring that bank management takes corrective action before problems compromise the safety and soundness of a bank. This approach requires an understanding of the operations of each bank or thrift and the systems each has in place to control risk, with consideration of the institution's size, scope of operations, complexity, and the risks presented by its business model.

Our supervision by risk framework establishes an examination philosophy and structure that is used at all national banks, federal savings association, federal branches of foreign banks, and national trust companies. This approach includes a common risk assessment system (RAS)¹ that evaluates each bank's risk profile across eight risk areas—credit, interest rate, liquidity, price, operational, compliance, strategic, and reputation—and assigns each bank an overall composite rating and component ratings on the bank's capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risks using the interagency Uniform Financial Institutions Ratings System (informally known as CAMELS).² Specific examination activities and supervisory strategies are tailored to each bank's risk profile. These strategies are

¹ See OCC Bulletin 2015-48, "Risk Assessment System" December 3, 2015 (<https://www.occ.gov/news-issuances/bulletins/2015/bulletin-2015-48.html>).

² See *Comptroller's Handbook*, "Bank Supervision Process" booklet, which explains UFIRS/CAMELS (<https://www.occ.gov/publications/publications-by-type/comptrollers-handbook/bank-supervision-process/pub-ch-bank-supervision-process.pdf>).

updated and approved annually. While tailored to each individual bank's risk profile, they also incorporate key agency supervisory priorities for the coming year.

To reflect the different expectations for controls and risk management between banks of varying sizes, operations, and complexity; our bank supervision programs and core examination procedures for determining a bank's RAS and CAMELS ratings are aligned across two primary lines of business: Midsize and Community Bank Supervision and Large Bank Supervision.

Our community bank supervision program is built around local field offices in more than 60 communities throughout the United States. Every community national bank is assigned to an examiner who monitors the bank's condition on an on-going basis and who serves as the focal point for communication with the bank. The primary responsibility for the supervision of individual community banks is delegated to a local Assistant Deputy Comptroller, who reports to a district Deputy Comptroller, who in turn, reports to the Senior Deputy Comptroller for Midsize and Community Bank Supervision. This structure allows community and midsize banks to benefit from assigned teams with thorough knowledge of local conditions and support from national resources with broad industry insight.

The frequency of on-site examinations for community banks follows the statutory provisions set forth in 12 USC 1820(d),³ with on-site exams occurring every 12 to 18 months. The scope of these examinations is set forth in the OCC's Community Bank Supervision handbook⁴ and requires sufficient examination work and transaction testing to complete the core assessment activities in that handbook, and to determine the bank's RAS and CAMELS ratings.

³ 12 USC § 1820(d) prescribes the annual examination requirement. As noted earlier, that provision has been amended by the Economic Growth Act to expand eligibility for an 18-month exam cycle to well-managed and well-capitalized banks under \$3 billion in assets.

⁴ "Community Bank Supervision" booklet of the *Comptroller's Handbook*, October 2017 (<https://www.occ.gov/publications/publications-by-type/comptrollers-handbook/community-bank-supervision/index-ch-community-bank-supervision.html>).

On-site activities are supplemented by off-site monitoring and quarterly analyses and discussions to determine if significant changes have occurred in the bank's condition or activities.

The OCC's Large Bank Supervision program is centralized and headquartered in Washington, D.C. It is structured to promote consistent uniform coordination across institutions. As part of the Large Bank program, the OCC assigns examination staff who are resident on-site at the institution and who conduct on-going supervisory activities and targeted examinations in specific areas of focus. This process allows the OCC to maintain an on-going program of risk assessment, monitoring, and communication with bank management and directors. Given the volume and complexity of the literally millions of transactions that flow through large banking organizations each day, it is not feasible to review every transaction in each bank, or for that matter, every single product line or bank activity in each supervisory cycle. Nonetheless, the scope and frequency of the OCC's targeted examinations and our constant, day-to-day supervision ensure that examiners complete sufficient work and transaction testing throughout the year to complete the core assessment activities set forth in the OCC's Large Bank Supervision handbook,⁵ and to determine the bank's RAS and CAMELS ratings. The on-site teams at each bank are led by an Examiner-in-Charge, who reports directly to the Deputy Comptrollers in our Large Bank Supervision Office, and in turn, to our Senior Deputy Comptroller for Large Bank Supervision. On-site examiners are supported by specialized examiners in the OCC's lead expert program and the Compliance and Community Affairs unit which provides a horizontal view across the industry, a focus on particular risks, and can quickly share insight from that broader perspective.

⁵ "Large Bank Supervision" booklet of the *Comptroller's Handbook*. October 2017 (<https://www.occ.gov/publications/publications-by-type/comptrollers-handbook/large-bank-supervision/pub-ch-large-bank-supervision.pdf>).

Supporting OCC examination staff is a nationwide network of lawyers, economists, accountants, compliance, and administrative and policy experts who together make the OCC the world's preeminent prudential supervisor. This network of experts brings a broad national perspective to complement the deep local expertise of the assigned exam teams.

The quality of that supervision contributes to the strong condition of the federal banking system today. The system has rebounded from the crisis. Capital and liquidity are near historic highs. Bankers understand the risks facing their banks better than at any point in my 35-year banking career. Return on equity and asset quality are approaching pre-crisis levels. Bank profitability improved in 2017 when compared with 2016 on a pre-tax basis. OCC-supervised banks reported healthy revenue growth in 2017 compared with 2016. Net income was flat for banks with total assets less than \$1 billion and declined 8.5 percent for the federal banking system because of the effect of the Tax Cuts and Jobs Act. Pre-tax income rose 4 percent in 2017 for the federal banking system and more than 7 percent for banks with assets less than \$1 billion. That improvement continued into the first half of this year, and the economic environment is expected to continue to support loan growth and bank profitability through 2019.

III. Risks Facing the Federal Banking System

Despite the relative strength of the banking system and health of the economy, the regulators' job is to peer over the horizon and assess any gathering storm clouds. The OCC publishes its view of risks facing the banking system twice each year in its *Semiannual Risk Perspective*.⁶ Our objective is to provide transparency around trends and potential risks so that the industry takes these risks into account and adjusts their practices accordingly. The most

⁶ See *Semiannual Risk Perspective*, Spring 2018 (<https://www.occ.gov/publications/publications-by-type/other-publications-reports/index-semiannual-risk-perspective.html>).

recent edition of the report, published on May 24, primarily focuses on credit, interest rate, operational, and compliance risks.

Credit Risk

At this point in a long economic expansion, asset quality metrics are, as is typical, very good, and changes in risk appetite and external factors are the primary drivers of credit risk and future performance. While overall credit quality remains strong, bankers must remain vigilant about the potential effects of competition and undue complacency on the quality of new loans and credit risk management. Recent reviews of underwriting indicate that satisfactory policies and practices exist to guide lending decisions and that, thus far in this economic cycle, banks as a whole are operating within established risk tolerances. Competition for quality loans remains strong, however, and examiners note evidence of eased underwriting, increased commercial real estate concentration limits, and a higher level of concerns related to policy exceptions. The accommodating credit environment warrants a continued focus on underwriting practices to monitor and assess credit risk and prevent lender complacency.

Overall lending grew 3.6 percent within the federal banking system in 2017. That growth continues the positive trend of the last several years, albeit somewhat slower in 2016 and 2017 than in previous years. Commercial loan growth for large banks, which hold more than 83 percent of all loans, fell to 4.2 percent, down from the 10-percent level two years ago. Although loan growth has slowed, growth rates still represent a healthy economy. Midsize and community banks continued to experience significant loan growth, particularly in commercial real estate and other commercial lending, which grew almost 9 percent last year. Such growth heightens the need for strong credit risk management and effective management of concentration risk.

Interest Rate Risk

At the same time, rising interest rates also pose a number of potential risks for some banks. Although rising interest rates generally increase net interest margins at small banks, bank investment portfolios with concentrations of long-duration and low, fixed-rate assets could erode in value as interest rates rise, particularly if they increase more abruptly than expected. Rising interest rates also likely will increase the cost of deposits because of competitive pressures particularly for banks with total assets of \$250 billion or more that are subject to additional regulatory liquidity requirements.⁷ Banks should be modeling these potential risks as part of sound balance sheet management.

Credit risk is also likely to increase as interest rates rise. Rising interest rates will often increase debt service costs and may affect credit affordability as well as repayment capacity of some financially stretched customers.

Operational Risk

Operational risk remains elevated as banks adapt business models to the evolving banking environment, transform technology and operating processes, and respond to increasing cybersecurity threats. The speed and sophistication of cybersecurity threats show no signs of abating. Banks face constant threats from bad actors seeking to exploit personnel, processes, and technology. Some of these threats target large quantities of personally identifiable information and proprietary intellectual property to facilitate fraud and misappropriation of funds at the retail and wholesale levels. Other threats are aimed at disrupting or otherwise impairing operations. Failure to maintain proper controls over cybersecurity can lead to material negative effects on

⁷ See OCC Bulletin 2014-51 (<https://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-51.html>), which describes the Liquidity Coverage Ratio final rule and provides a link to that rule.

financial institutions, consumers, and national and economic security. Banks also continue to rely on third-party relationships to support a significant number of key services and operations because of the greater economies of scale and advanced technical resources that allow them to manage operations better and more efficiently. Banks need to manage risks associated with using third parties⁸ through appropriate due diligence and risk oversight to ensure controls protecting the confidentiality, integrity, and availability of systems and data are maintained. Increasing consolidation among large technology service providers has created third-party concentration risk, in which a limited number of providers service large segments of the banking industry for key financial services. Operational events at these larger service providers could affect large parts of the financial industry, if not properly managed by the service providers and the banks that rely on their services. The OCC and the other federal banking agencies continue to prioritize supervisory activities related to these large service providers.

Cybersecurity and operational issues have a greater potential to affect individual consumers, business, and communities than ever before. As innovation and technology moves us toward greater interconnectedness and reliance on online transactions, outages and breaches generate greater disruption in how we conduct our lives and businesses. Extended outages of bank websites and applications, automated teller networks, or payments systems can paralyze commerce and undermine overall confidence in our system. To avoid these consequences, banks, retailers, nonbank service providers, and regulators must be vigilant in working together to protect the system and improve its resiliency.

⁸ See OCC Bulletin 2013-29, “Third-Party Relationships” (<https://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html>).

Compliance Risk

Compliance risk remains elevated as banks manage risks in an increasingly complex environment and work to comply with evolving regulations.

The dynamic nature of money-laundering and terrorist-financing methods present challenges for banks to comply with the Bank Secrecy Act (BSA) requirements. Banks offer new or evolving delivery channels that increase customer convenience and access to financial products and services, and they must maintain a focus on refining or updating BSA compliance programs to address vulnerabilities in these new delivery channels that criminals seek to exploit. At the same time, recent changes to the regulatory framework implementing the BSA increase the burden of complying with the law. One example involves the Financial Crimes Enforcement Network's (FinCEN) new requirements for conducting customer due diligence and documenting the beneficial ownership of companies conducting financial transactions. While these new requirements enhance the transparency and confidence of financial transactions, they place significant new burden on financial institutions.

Other complex and constantly changing regulations also strain bank compliance management systems and change management processes, which increases operational, compliance, and reputation risks. Recent regulatory changes in the consumer compliance area include changes in the requirements under the Home Mortgage Disclosure Act and Military Lending Act, and implementation of the integrated mortgage disclosures under the Truth in Lending Act and the Real Estate Settlement Procedures Act. Banks need consumer compliance risk management and audit functions sufficient to promote ongoing compliance with regulations, even those that change on a frequent basis.

IV. My Priorities as Comptroller of the Currency

As Comptroller, my short-term priorities have focused on initiatives to help banks promote job creation and economic opportunity while continuing to operate in a safe, sound, and fair manner. These priorities include modernizing the regulatory approach to the Community Reinvestment Act (CRA), encouraging banks to meet consumers' short-term, small-dollar credit needs, enhancing our supervision of BSA/anti-money laundering (AML) compliance and making it more efficient, simplifying regulatory capital requirements, and reducing burden associated with the Volcker Rule. At the same time, we continue to enhance the agency's effectiveness and efficiency.

Modernizing Our Approach to the CRA

During the four decades since the CRA became law, the regulatory approach to implementing that law has become too complex, outdated, cumbersome, and subjective. We have an opportunity to modernize the regulatory framework around CRA to better serve its original purpose and encourage more investment and banking activity supporting the people and communities needing it most.

As a banker for more than 30 years, I saw firsthand the benefit of CRA activities and how they make communities more vibrant. I believe in the power of community reinvestment to reinvigorate financially distressed areas and to give residents of those neighborhoods new hope and new economic opportunities. I have been involved in directing hundreds of millions of dollars in community development, reinvestment, and support for groups that provide important services to their communities, and I want to expand the types of activities eligible for CRA consideration to include more small business lending and community development activities and strengthen the CRA regulatory framework to benefit future generations.

Stakeholders from all perspectives have called for modernizing the current regulatory framework for the CRA. Members from both sides of the aisle have described their frustration with some of the CRA regulatory framework's current limitations. Many have complained of significant administrative burden, lack of incentives for investment, and failure to adapt to advances in banking such as interstate branching and digitization of services. Others have complained about the limited opportunity for bank activities to qualify for CRA consideration. Bankers and community groups alike criticize the length of time between the issuance of CRA performance evaluations, the unwieldy length of performance evaluation reports, and the lack of transparency, clarity, and flexibility with respect to regulatory requirements and processes. The complaints I hear most frequently are that the current approach to evaluating CRA performance is too subjective and costly.

To begin the process of modernizing the CRA, the federal banking agencies are discussing an Advanced Notice of Proposed Rulemaking (ANPR) soliciting comments from stakeholders on how best to modernize the CRA regulatory framework. We have an opportunity to consider a transformational CRA framework that would: (1) expand and provide clarity regarding the bank activities that receive CRA consideration; (2) revisit the concept of assessment areas; and (3) increase the transparency of how bank CRA performance is measured by using quantitative standards that are applied consistently.

First, we should expand the types of activities that qualify for CRA consideration. Over the years, opportunities for CRA consideration have focused heavily on single- and multi-family residential lending. While necessary for a vibrant community, residential lending is not the only activity that can have a meaningful impact in these communities. Communities also need more small business lending, student lending, economic development opportunities, and in some cases,

additional opportunities for consumers to access credit including responsible, short-term, small-dollar consumer loans. These activities deserve more consideration during CRA evaluations. We have the opportunity to encourage banks to help neighborhoods become communities where families can make a living and not just reside.

Second, we need to revisit the concept of assessment areas. Limiting assessment areas to a bank's branch-based footprint has become an impediment to investment and providing capital in areas of need that the bank may serve. I have seen situations where projects have not received CRA consideration merely because they were on the wrong side of a street. I have also seen needy communities go unserved or have much needed resources delayed because of a lack of clarity in current regulations. In reconsidering assessment areas, we need to broaden our thinking to include all areas where institutions provide their services rather than only narrow geographies defined by branches and deposit-taking automated tellers.

Third, we need to develop a metrics-driven approach to evaluating CRA performance using clear thresholds. Such changes could make facts and data regarding a bank's CRA activity more transparent and available to the public more frequently. Establishing clearer, more transparent metrics for what banks need to do to achieve a certain CRA rating would allow stakeholders to understand how a bank is working to meet the credit needs of its community, provide a more objective base for examiner ratings, and allow regulators to report on aggregate activity to show a bank's overall performance. Clear thresholds would minimize subjectivity, encourage consistency, and promote transparency in contrast with today's evaluations that may rate similar activities differently from bank to bank and make comparisons across institutions difficult and less meaningful. This type of change would also help regulators to make decisions

that rely on CRA data more quickly and to produce more concise and meaningful performance evaluations.

The ANPR will solicit comments on all possible approaches to modernizing CRA, including modest changes to the existing CRA framework and more transformational changes. It also will seek feedback on allowing community banks to retain a more traditional approach based on their business models.

Once published, I encourage all stakeholders to provide their thoughts on how to improve our approach to the CRA regulatory framework to better encourage banks to meet the credit needs of their communities, including those in low- and moderate-income neighborhoods, consistent with the safe and sound operation of these institutions. I recognize that there are many people and organizations with decades of experience in this important field. I look forward to publishing the ANPR and reviewing the comments received as we move ahead.

Encouraging Banks to Meet Consumer's Short-term, Small-dollar Credit Needs

Millions of Americans rely upon short-term, small-dollar credit to make ends meet, but have few choices in this area. According to one study, U.S. consumers borrow nearly \$90 billion every year in short-term, small-dollar loans typically ranging from \$300 to \$5,000.⁹ Consumers need safe, affordable choices, and banks should be part of that solution. While banks may not be able to serve all of this market, they can reach a significant portion of it and bring additional options and more competition to the marketplace while delivering safe, fair, and less expensive credit products that support the long-term financial health of their customers.

⁹ Refer to Center for Financial Services Innovation, "2017 Financially Underserved Market Size Study," pp. 44–47, for revenue and volume data on pawn loans, online payday loans, storefront payday loans, installment loans, title loans, and marketplace personal loans.

That is why the OCC clarified its position in a bulletin published on May 23, 2018, that encourages banks to offer responsible short-term, small-dollar installment loans to help meet the credit needs of their customers.¹⁰

Banks are well suited to offer affordable short-term, small-dollar installment lending options that can help consumers find a path to more mainstream financial services without trapping them in cycles of debt. When banks offer products with reasonable pricing and repayment structures, consumers can benefit from banks' other financial services such as financial education and the opportunity to build a positive credit record.

Banks should consider the following three core principles when offering short-term, small-dollar lending products.¹¹

- All bank products should be consistent with safe and sound banking, treat customers fairly, and comply with applicable laws and regulations.
- Banks should effectively manage the risks associated with the products they offer, including credit, operational, compliance, and reputation.
- All credit products should be underwritten based on reasonable policies and practices, including guidelines governing the amounts borrowed, frequency of borrowing, and repayment requirements.

The agency's bulletin also highlighted reasonable policies and practices specific to short-term, small-dollar installment lending, including:

¹⁰ See OCC Bulletin 2018-14, "Installment Lending: Core Lending Principles for Short-Term, Small-Dollar Installment Lending" (<https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html>).

¹¹ Refer to [OCC NR 2017-118](#).

- Loans and terms that align with eligibility and underwriting criteria. Products should be designed to achieve reasonable borrower affordability and repayment.
- Loan pricing that complies with applicable state laws and reflects overall returns reasonably related to product risks and costs. The OCC views unfavorably an entity that partners with a bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing state(s).
- Analysis that uses internal and external data sources, including deposit activity, to assess a consumer's creditworthiness and to effectively manage credit risk. Such analysis could facilitate sound underwriting for credit offered to consumers with an ability to repay but who do not meet traditional standards.
- Marketing and customer disclosures that comply with consumer protection laws and regulations and provide information in a transparent, accurate, and customer-friendly manner.
- Loan servicing processes that assist customers, including distressed borrowers. To avoid continuous cycles of debt and costs disproportionate to the amounts borrowed, timely and reasonable workout strategies should be used.
- Timely reporting of a borrower's repayment activities to credit bureaus. Borrowers should have the ability to demonstrate positive credit behavior, build credit history or rebuild credit scores, and transition into additional mainstream financial products.

The Pew Charitable Trusts praised the OCC's action when announced by saying the action encourages "the other federal bank and credit union regulators to follow the Comptroller's lead and institute the necessary standards to ensure the development of safe and affordable small installment loans that will save millions of borrowers billions of dollars a year." The OCC also is

working with Congress to encourage the banking sector to offer additional short-term, small-dollar lending products to meet consumer needs. I want to commend Representative Hollingsworth for his legislation to support efforts by the banking regulators in this area.

Enhancing BSA/AML Compliance

The BSA and AML laws and regulations exist to protect our financial system from criminals who would exploit that system for their own illegal purposes and from use of that system to finance international terrorism. Bank regulators, law enforcement, national security personnel, and bankers must continually adapt to increasingly sophisticated criminals and other illicit actors who take advantage of the nation's banks and financial system. While regulators and the industry share a commitment to fighting money laundering and other illegal activities, the process for complying with current BSA/AML laws and regulations has become inefficient and costly. Banks spend billions each year to comply with BSA/AML requirements. We need to reform the BSA/AML to be more efficient while improving the ability of the federal banking system and law enforcement to safeguard the nation's financial system from criminals and terrorists.

In May, the federal banking regulators met to discuss ideas on how to improve our approach to implementing BSA/AML laws and regulations and presented those recommendations to the Department of the Treasury and FinCEN.

There are several improvements that the OCC believes could be addressed through regulation and others that would need legislative relief. Opportunities include:

- Allowing regulators to schedule and scope BSA/AML examinations on a risk-basis and identifying ways to conduct associated examinations in a more efficient manner.

- Considering changes to the threshold requiring mandatory reporting of Suspicious Activity Reports (SARs) and currency transaction reports and simplifying reporting forms and requirements.
- Working with law enforcement to provide feedback to banks so that they understand how SARs and other BSA report filings are used and can provide the most useful information.
- Exploring the use of technologies to reduce reporting burden and provide more effective access and information to law enforcement and national security personnel.

I look forward to working with my fellow banking regulators, Treasury, FinCEN, law enforcement, and national security personnel in the coming months to identify changes we can implement to reduce the burden of complying with BSA/AML laws while also improving how we protect our financial system

I also look forward to working with Members of Congress who are interested in improving the BSA/AML laws. I am supportive of many of the provisions included in draft legislation authored by Subcommittee Chairman Luetkemeyer and Representative Pearce that, among other things, would change reporting thresholds and provide additional authority for industry participants to enhance their vigilance by sharing information about certain unlawful activities in addition to possible terrorist or money laundering activities.

Simplifying Regulatory Capital and the Volcker Rule

Following the financial crisis, bankers, regulators, and policy makers responded by appropriately focusing on improving the quality and quantity of capital and liquidity in the banking system. As a result, today's financial institutions have capital and liquidity near historic highs. At the same time, calculating regulatory capital has become too complex. Even some of

the most seasoned bankers need the assistance of a capital expert to understand and explain how the various categories of capital are counted. This results in regulatory and business inefficiency and places an unnecessary burden particularly on well-capitalized community and midsize banks.

In late October 2017, federal bank regulators proposed a rule intended to reduce burden by simplifying several requirements in the agencies' regulatory capital rule.¹² Most aspects of the proposed rule would apply only to banking organizations that are not subject to the "advanced approaches" in the capital rule, which are generally firms with less than \$250 billion in total consolidated assets and less than \$10 billion in total foreign exposures. The proposal would simplify and clarify a number of the more complex aspects of the existing capital rule. The federal banking agencies received a number of comments on various aspects of the proposal and are working together to consider what changes to the proposal would be appropriate in light of the different ideas and suggestions provided in the comments. Additionally, one area of the proposal—the treatment of acquisition, development, and construction loans—has been superseded by the Economic Growth Act. As we move forward with our efforts to simplify and clarify our regulatory capital requirements, the agencies will, of course, make any changes necessary to conform our capital rules to the new law.

In April of this year, the OCC and the Board of Governors of the Federal Reserve System proposed a rule that would further tailor leverage ratio requirements to the business activities and risk profiles of the largest domestic firms.¹³ Currently, firms that are required to comply with the "enhanced supplementary leverage ratio" are subject to a fixed leverage standard, regardless of their systemic footprint. The proposal would instead tie the standard to the risk-based capital

¹² 82 Fed. Reg. 49984 (October 27, 2017).

¹³ 83 Fed. Reg. 17317 (April 19, 2018)

surcharge of the firm, which is based on the firm's individual characteristics. The resulting leverage standard would be more closely tailored to each firm. Importantly, the Economic Growth Act includes a provision (section 402) that requires the agencies to make changes to the calculation of the supplementary leverage ratio for banking organizations engaged in custody, safekeeping, and asset servicing activities. As we move forward with the changes required by the new law, we will need to consider whether the proposed recalibration of the enhanced supplementary leverage ratio remains appropriate, or whether additional fine tuning will be necessary.

I also look forward to working with fellow regulators to update regulations to implement additional relief authorized in the Economic Growth Act. Among those provisions are section 201 which allows banks that exceed a "community bank leverage ratio" (tangible equity to average total consolidated assets of 8 percent to 10 percent) to be deemed to be in compliance with current leverage and risk-based capital provisions. This will greatly reduce regulatory burden for well-capitalized, qualifying institutions.

Similarly, the agencies have been working to simplify the Volcker Rule¹⁴ to ease associated burden, particularly for those community and midsize banks that do not pose systemic risk to the nation's financial system and typically do not engage in the type of activities that the statute was intended to address. I also applaud the changes made by the Economic Growth Act to reduce the number of banks subject to the Volcker Rule and want to thank the many members of this committee who have long supported this reasonable exemption.

¹⁴ 12 USC 1851; 12 CFR 44.

For those entities that remain subject to the rule, the OCC is committed to adding clarity and reducing unnecessary burden, as appropriate. In August 2017, the OCC sought public comment about what should be done to improve the current regulation implementing the Volcker Rule¹⁵ and specifically invited input on ways to tailor the rule's requirements and clarify key provisions that define prohibited and permissible activities. The agency also sought input on how the federal regulatory agencies could implement the existing rule more effectively without revising the regulation. The OCC has used comments to inform its dialogue with other federal regulatory agencies.

The OCC has worked collaboratively with the other federal regulatory agencies responsible for the Volcker Rule to develop a proposed rule that would clarify and streamline the current regulation. These proposed changes focus on reducing the subjectivity, and associated uncertainty, of the current rule. A key objective is to provide clear lines that enable firms to quickly and easily determine whether activities are subject to the rule. In this regard, the proposal seeks to eliminate the test that looks to the subjective intent of a transaction for purposes of determining whether it is proprietary trading and to focus on objective factors. For example, a trading desk that operates within a prescribed profit and loss threshold would be presumed to be operating in compliance with the rule unless the appropriate agency determines otherwise.

In addition, the proposed rule focuses on appropriate burden reduction by seeking to calibrate the regulation to the type and level of risk presented. For example, a bank with only moderate trading activities would be eligible for streamlined versions of the market-making and hedging exemptions relative to a bank that has significant trading activities. For banks with the

¹⁵ 82 Fed. Reg. 36692 (August 7, 2017).

most limited trading activities, there would not be any ongoing obligation to demonstrate compliance, although the rule's substantive restrictions on proprietary trading and covered funds activities would still apply. We believe these changes will reduce burden, particularly for smaller and midsize banks that remain subject to the Volcker Rule following the recent statutory amendment. We believe these changes will also improve the agencies' implementation of the Volcker Rule by allowing regulators to focus on the activities that were at the core of the statutory prohibitions.

Each of the five agencies involved in writing the rules implementing the Volcker Rule has adopted the proposal, and I look forward to working with my fellow regulators to finalize changes to the Volcker Rule later this year.

Agency Effectiveness and Efficiency

Ensuring that the OCC operates as effectively and efficiently as possible allows the agency to succeed in its mission, to be a responsible steward of every assessment dollar collected, and to maintain a professional and inspiring workplace for the men and women who contribute to the economic security of our nation by supervising its banks.

Since I arrived at the OCC, we have greatly improved the agency's decision-making processes. Over the years, the OCC had developed a centralized and bureaucratic approach to decision making that required multiple officials and many layers of review to approve examiner guidance, internal policies, and public issuances. We have three months of data that tell us that the change is paying dividends. The average total time for executive managers to review documents and agency decisions is now less than eight days, down from an average of nearly 22 in calendar year 2017. The revised process also pushes decision making down to appropriate

staff. Under the revised process, for example, the Comptroller's approval has been required on 54 percent of the documents issued by the agency, compared with 97 percent of documents reviewed at the agency in 2017. This more efficient approval and coordination process reduces waste and allows more resources to be committed to executing decisions rather than coordinating their approval. We continue to look for opportunities to make that process even more efficient and reduce the time even further.

The agency has also focused on reducing its costs through gaining efficiencies and making better use of technology. When I arrived at the OCC, I was greeted with 18-inches of three-ring binders for briefings the next day. Executives would arrive to meetings with their binders and coordination packages would be copied and bound for each of them. Today, we have significantly reduced paper received by my office and coordinate all materials electronically. Executives largely rely on electronic communication, and staff share information and document decisions online. Moving to an online-only system has saved an incalculable amount of paper and time—time spent under the old process assembling and delivering paper packages for each reviewer. Now, because comments are now provided electronically, we have eliminated the need to copy and scan comments by reviewers, decipher handwritten notes, and track down the commenter when follow-up is required. Recordkeeping is accomplished more quickly because all the documents are electronic and easily saved to the initiating office's system of records.

The agency is also mindful of our responsibility to get the most out of every dollar assessed to the institutions we supervise and is working to reduce costs wherever it makes sense. At the beginning of fiscal year 2018, the OCC supervised 1,347 institutions and had authorized 3,945 full-time employees. After I became Comptroller, OCC management conducted a thorough budgetary review and identified efficiencies to fulfill our mission and lower our expected

expenses by reducing the number of additional personnel we planned to hire during the year, prioritizing our work, completing that work more efficiently, and taking a closer look at actual versus planned spending for personnel travel and contracts. That effort reduced the amount we planned to spend in fiscal year 2018 by nearly \$70 million, or about 5 percent of our expected costs.

As the agency looks ahead to fiscal year 2019, we will think even more critically and creatively about what we need to do our jobs successfully and reduce our anticipated costs further. There are many ways to save money and operate more efficiently and effectively, and currently none of them involve a reduction-in-force through layoffs or buyouts. As the agency plans its spending for fiscal year 2019 and beyond, we will seek to optimize our real estate strategy by shrinking our physical footprint and taking advantage of technology to reduce our costs. Our revised spending plan for the remainder of fiscal year 2018 and the budgets I authorize in the future will continue to provide the resources necessary for the agency to succeed in its mission and to provide employees an engaging and fulfilling work experience. The agency will continue to invest in training and career development while providing a professional, supportive workplace so that the agency can attract and retain the experience and talent it needs.

V. Conclusion

Thank you for the opportunity to provide my views on the condition of the federal banking system, risks facing that system, and my priorities as Comptroller. I look forward to working with members of this committee, my fellow regulators, and the seasoned team at the OCC to address these important issues facing our nation's banks and to further strengthen the federal banking system.

I again congratulate the Chairman on the effectiveness of his leadership and I thank the committee for your important and formative work resulting in the package of bipartisan, common sense relief for community and midsize banks that was passed into law last month.