

Remarks by
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Good morning, and thank you for joining today's call regarding our *Semiannual Risk Perspective* for fall 2016. The *Semiannual Risk Perspective* highlights in a transparent way the risks facing the federal banking system and our priorities as supervisors of national banks and federal savings associations.

The overall condition of the federal banking system is sound with financial performance relatively unchanged year-over-year. As I have mentioned in recent speeches, capital, liquidity, and leverage are all vastly improved since the dark days of the crisis. Since the crisis, we've seen improvement in banks of all sizes with the return on equity at community banks nearly recovering to pre-crisis levels.

Despite the steady progress and relative strength of the system, as a career regulator I know the worst loans are made in the best of times, as they say, and we must be vigilant now against risks accumulating in the system and we must avoid rolling back the safeguards that have helped the system recover. Banks and thrifts are strong and profitable because of earlier recognition of losses and troubled assets and the discipline to work through those issues aggressively. This report highlights where we see particular risks facing national banks and federal savings associations.

These key risks include strategic, credit, operational, and compliance risks. While these concerns are broadly the same as in our prior report, we've added governance over sales practices to that list. As I testified this past September after the OCC's actions against Wells Fargo for failures in governance of its sales practices, the OCC initiated a broader review to assess whether similar practices and weaknesses are occurring in other large and midsize banks. Work on the review continues.

While this report provides more detail on all of these key risks, I want to stress several things.

First, strategic risk remains a key risk for banks of *all* sizes. Banks are adopting more innovative products, services, and processes in response to the evolving demands for financial services and the entrance of new competitors, such as out-of-market banks and financial technology firms. In addition, some banks are considering business model changes, including mergers and acquisitions, as they search for acceptable returns in a prolonged environment of low interest rates. And, in some cases, banks face issues with succession and long-term planning.

Next, at this point in the economic cycle, credit risk is accumulating in the federal banking system as a result of significant loan growth in an increasingly competitive environment, easing in underwriting, and increasing concentrations. In our 22nd annual *Survey of Credit Underwriting Practices*, published last month, examiners reported seeing incremental easing in underwriting standards across a variety of commercial and retail loan products for the fourth consecutive year. In commercial lending, banks are making concessions on pricing, loan covenants, and guarantor requirements. In retail lending, we see easing most often in loan-to-value, loan size, and debt-to-income requirements.

At the same time underwriting is loosening, we are seeing some concentrations grow, particularly in exposures to commercial real estate and to non-bank lenders. Our concern with commercial real estate concentrations is principally focused toward the community and midsize bank portfolios, while the increased lending to the shadow banking sector is principally among our larger banks. In the aggregate, loan growth remains strong across all banks, particularly commercial loans which grew over 10 percent in the last year.

The increase in credit risk highlights the necessity that banks maintain appropriate level of loan loss reserves. Recent supervisory activities have identified weaknesses in reserve method at some banks, specifically the inadequate consideration of rapid loan growth, greater concentrations of credit, and a higher risk appetite and tolerance for underwriting exceptions.

Operational risk also remains high on our radar as banks adapt business models, transform technology and operating processes, and respond to increasing cyber threats. Well-publicized breaches have made cybersecurity a household topic, and banks and regulators must continuously up their game to protect against the latest cyber attack and ensure they are capable of maintaining their operations and recovering in the event that an attack does occur.

Finally, compliance continues to be a challenge for many banks, particularly with the Bank Secrecy Act (BSA) and the change management necessary to comply with new or amended regulations, including the amended Military Lending Act rules and integrated mortgage disclosure requirements. Compliance must receive the same focus as safety and soundness for a bank to succeed, which is why last year we created a new executive-level department dedicated to compliance policy and supervision. By focusing OCC resources on compliance, we send a clear message of the importance of compliance and ensure issues are addressed appropriately in

each exam to ensure fair access and fair treatment of consumers and compliance with other applicable laws and regulations like BSA.

While these risks have not changed dramatically since the last report, they highlight that we must maintain our focus to ensure banks effectively management these risks so that the federal banking system can continue to meet the needs of the consumers, businesses, and communities it serves. With that, I'd like to take a few of your questions.