For Release Upon Delivery
10:00 a.m., December 6, 2011

TESTIMONY OF

JOHN WALSH
ACTING COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

December 6, 2011

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.

Chairman Johnson, Ranking Member Shelby, and members of the Committee, I appreciate the opportunity to provide the Committee with a progress report on the initiatives the Office of the Comptroller of the Currency (OCC) has undertaken to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Dodd-Frank) since July 21, 2011. The Committee's letter of invitation requests that I testify about any significant actions and rules proposed or finalized by the OCC since July 21, 2011. In particular, the Committee is interested in hearing about the OCC's progress in carrying out its responsibilities with respect to the Volcker Rule, the integration of the Office of Thrift Supervision (OTS) into the OCC pursuant to Title III of the Dodd-Frank Act, risk retention provisions under Title IX of Dodd-Frank, and the OCC's contributions to the Financial Stability Oversight Council (FSOC) and coordination with other member agencies.

Accordingly, my testimony highlights the OCC's work in the following key areas:

- The integration of the functions of the former OTS with respect to federal savings associations, and former OTS staff, into the OCC, and the companion effort to integrate, where appropriate, federal savings association regulations and policies into the regulations and policies for national banks;
- Our efforts to date to work with the Bureau of Consumer Financial Protection (CFPB) as it commences operations;
- An update on the OCC's contributions to, and participation in, the FSOC;
- OCC efforts underway to implement the Dodd-Frank Act provisions that strengthen risk-based capital, leverage, and liquidity requirements; and

- Our progress in regulatory implementation of certain other key Dodd-Frank Act provisions.

I. OTS/OCC Integration

General

On July 21, 2011, Dodd-Frank transferred to the OCC all functions of the OTS relating to federal savings associations, and the OCC assumed responsibility for the ongoing examination, supervision, and regulation of federal savings associations. From an operational perspective, the integration of the OTS into the OCC has been successfully completed. We have fully integrated OTS staff into all departments of the OCC's organizational structure. Combined examination teams have begun working on exams at national banks and federal savings associations. Prior to July 21, 2011, the OCC communicated extensively with the thrift industry to prepare for this transfer of responsibility from the OTS to the OCC. Since that time, we have continued to participate in a variety of outreach activities to maintain an active dialogue with federal savings associations, including several national teleconferences on supervisory issues of specific interest to them. We also will continue and expand the former OTS advisory committees on mutual savings associations and minority institutions as venues for important input on the unique challenges facing those institutions. And, as new issues emerge, the OCC will continue to communicate regularly with the thrift industry to clarify our expectations and respond to its concerns.

Integration of Regulations

As I explained in my testimony before this Committee in July 2011, the OCC is in the process of undertaking a comprehensive, multi-phased review of its regulations, as

well as those of the OTS, to eliminate duplication and reduce unnecessary regulatory burden. On July 21, 2011, the OCC issued a final rule revising certain OCC rules that are central to internal agency functions and operations to take into account the transfer to the OCC of jurisdiction over federal savings associations. The final rule also conformed the OCC's preemption and visitorial powers regulations to the Dodd-Frank Act provisions that became effective on July 21st. The OCC also issued an interim final rule, effective on July 21, 2011, that republished most OTS regulations in the OCC's chapter of the Code of Federal Regulations and renumbered them accordingly as OCC rules, with nomenclature and other technical amendments to reflect the OCC's responsibilities for federal savings associations. This action consolidates the regulations applicable to national banks and federal savings associations in the regulations of the OCC.

We are now in the process of further integrating and consolidating OCC and republished OTS regulations. We are considering more comprehensive substantive amendments to republished OTS regulations, as well as existing OCC rules, with the continuing objective of reducing duplication and providing consistent treatment, where appropriate, for both national banks and federal savings associations. We expect this process to result in a more streamlined set of regulations that aims to reduce unnecessary regulatory burden. Throughout this process, the OCC is mindful that the federal savings association charter has certain unique statutory attributes that are necessary to preserve. In all instances where revisions are undertaken, we will seek public comment to assist in making the regulations workable and effective for both national banks and federal savings associations.

A similar effort is underway to integrate the more than 1,000 OTS supervisory policies into a consolidated OCC policy framework. The goal is to produce a consistent supervisory approach and integrated policy platform for both national banks and federal savings associations, while recognizing differences anchored in statute. As part of this process, the OCC plans to rescind several hundred OTS documents that are duplicative or obsolete. The OCC will then focus on policy guidance documents that require substantive revision or combination, as well as policy guidance documents that are considered unique to savings associations. Upon completion, this process will result in a more streamlined set of policies for national banks and federal savings associations that should eliminate confusion associated with duplicative or obsolete policy documents.

Finally, the OCC has worked with the other federal banking agencies to move savings associations to common financial reporting forms by discontinuing the Thrift Financial Report (TFR), currently used by most savings associations to report financial data, and requiring these institutions to use instead the Consolidated Reports on Income and Condition (Call Reports) filed by banks. The OCC worked with the other banking agencies to reduce confusion and potential burden on savings associations by publishing a number of *Federal Register* notices, posting on the FFIEC and OTS Web sites a "mapping" document that links TFR data items to the appropriate line items in the Call Report, and participating in various industry panel discussions and teleconferences to discuss issues associated with the conversion. Although the agencies recognize that there will be some initial adjustment for savings associations related to this conversion, going forward having a common reporting form and platform provides long-term efficiencies to the agencies and savings associations.

II. Coordination with the Bureau of Consumer Financial Protection

In my previous testimony, I discussed the transition of certain OCC functions and staff to the CFPB, as well as our efforts to assist the CFPB in standing up its operations as of the designated transfer date. We continue to be actively engaged with the CFPB on a number of fronts relating to our respective roles and responsibilities in connection with supervision of compliance by national banks and federal savings associations with federal consumer financial laws, processing of related consumer complaints, and consultation on CFPB rulemakings.

There have been significant developments since the last hearing on this matter. Since that time, the CFPB commenced its operations, added staff, and engaged in a number of activities implementing the Dodd-Frank Act. For example, the CFPB has assumed responsibility for conducting examinations for compliance with federal consumer financial laws at national banks and federal savings associations with total assets greater than $10 billion and, as of the designated transfer date, the OCC is no longer responsible for such examinations at these institutions. The CFPB also has begun to develop and promulgate certain regulations.

In the last several months, the OCC has assisted the CFPB in a number of areas related to their operations. We have been providing the CFPB with significant staff and infrastructure support by processing consumer complaints on behalf of the CFPB. We entered into a Memorandum of Understanding (MOU) with the CFPB under which the OCC's Customer Assistance Group is performing intake, processing, analysis, and resolution of consumer complaints about national banks and federal savings associations with total assets of more than $10 billion. The CFPB is currently handling complaints

that concern credit cards offered by these large institutions, and plans call for them to begin handling those relating to mortgage lending and servicing this week. The OCC is handling all other complaints, but the MOU provides that the consumer complaint function for large institutions will be assumed in its entirety by the CFPB for all federal consumer financial laws over the course of the next several months as the CFPB develops the capacity to handle these obligations.

In addition, we recently issued a joint policy statement to clarify how the prudential regulators and the CFPB will measure the total assets of an insured depository institution for purposes of determining supervisory and enforcement responsibilities under the Dodd-Frank Act. Under section 1025 of the Dodd-Frank Act, the CFPB is given primary authority to examine an insured depository institution for compliance with federal consumer financial laws if the institution has total assets greater than $10 billion. The prudential regulators retain exclusive supervisory and enforcement authority for insured depository institutions with total assets of $10 billion or less. The interagency policy statement describes the agreed-upon measure and a schedule for determining asset size for these purposes by using the total assets reported in four consecutive quarterly Call Reports.

There is much that remains to be done, however. The OCC has established an internal Consumer Issues Steering Committee (CISC) to act as liaison with the CFPB on the coordination of supervisory and regulatory matters. CISC members have scheduled weekly meetings, and have more frequent informal communications with CFPB staff on examination coordination, information sharing, rulemakings, and consumer compliance issues.

One important project concerns the requirements for consultation by the CFPB with prudential regulators in connection with CFPB rulemakings. Under the Dodd-Frank Act, the CFPB has exclusive authority to prescribe regulations administering certain enumerated federal consumer financial laws. With respect to this rulemaking authority, the CFPB is required to consult with the prudential regulators prior to proposing a rule and during the rulemaking process "regarding consistency with prudential, market, or systemic objectives" administered by the prudential regulators. The law states that if, during the consultation process, a prudential regulator provides a written objection to all or any part of a proposed CFPB rule under consideration, the CFPB must describe the objection and how it addressed it in its adopting release. This consultation process is important to ensure meaningful input by prudential supervisors on CFPB regulations. The CFPB currently has in process several rulemakings where interagency coordination and consultation will be critical. These include the "ability to repay" requirements for "qualified mortgages," which should be carefully coordinated with the "qualified residential mortgage" criteria in the interagency risk retention rulemaking so that the interplay of the two standards is appreciated and unintended consequences do not result.

The OCC and the other prudential regulators are currently working to develop an agreement on a consultation process that will meet these statutory objectives and provide the prudential regulators with reasonable time to effectively review, discuss, and comment on CFPB rulemakings.

Another area of current discussion concerns implementation of the Dodd-Frank Act requirements that the CFPB coordinate its activities with the supervisory activities conducted by the prudential regulators in order to minimize regulatory burden on an

institution. Section 1025 requires the CFPB to consult with the prudential regulators regarding respective schedules for examining an institution. Similarly, the CFPB and the prudential regulators are required to conduct their respective examinations simultaneously in an insured depository institution and to share and comment on related draft reports of examination that result from the simultaneous examinations. The law also provides that the regulated institution may opt out of a simultaneous examination by the prudential regulator and the CFPB.

Candidly, aspects of this portion of the Dodd-Frank Act do not mesh well with how bank examination activities are actually conducted. Therefore, the OCC and the other prudential regulators have initiated efforts to develop a MOU that will implement these coordination requirements in a realistic and practical manner and prevent unnecessary regulatory burden on insured depository institutions – which we believe to have been the Congressional intent. We hope that uncertainty among regulated institutions about when and how they will be examined by the CFPB relative to their examinations by the prudential regulators can be clarified.

III. Activities of the Financial Stability Oversight Council

General

The OCC continues to be an active participant in the activities of the FSOC as it carries out its mission to identify and respond to emerging risks that threaten the financial stability of the U.S., to promote market discipline, and to facilitate coordination and information sharing among the various financial regulators.

Since my last update to this Committee in July, the FSOC issued its 2011 Annual Report to Congress, which includes a summary of both the state of the U.S. financial

system as a result of the 2007-09 market recession and some of the major forces that will shape the financial system's future development. The report also details the progress of key domestic regulatory reforms resulting from the implementation of the Dodd-Frank Act. In addition, the FSOC has held two formal meetings and convened several conference calls among its members to discuss current market developments. As described in more detail below, formal actions that the FSOC has taken during this period include the publication of an enhanced notice of proposed rulemaking and guidance on the process the FSOC proposes to use for designating systemically important nonbank financial firms for enhanced supervision by the Federal Reserve Board (FRB).

Equally important, however, have been the deliberations and information exchanges among agency principals and staff on market and regulatory developments that could have potential systemic risk implications for the U.S. financial sector and broader economy. These discussions have included updates on the agencies' ongoing assessments and analyses of the situation in the European financial markets and their potential ramifications for the U.S. and deliberations on various structural issues confronting the U.S. financial system that were identified in the FSOC's annual report, including money market fund reform, the tri-party repo market, and efforts to address and reform the U.S. housing market. Facilitating these types of candid, confidential exchanges of information is, I believe, one of the most critical functions of the FSOC.

Designations of Nonbank Financial Firms for Heightened Supervision

The FSOC also is continuing its work under the provisions of the Dodd-Frank Act that require the designation of nonbank financial firms for enhanced supervision by the FRB. Based on feedback received on an initial notice of proposed rulemaking issued in

January 2011, the FSOC determined that there was a need to seek comment on additional details regarding the standards for this designation process before issuing a final rule. On October 11, 2011, the FSOC issued a second notice of proposed rulemaking and proposed interpretive guidance (NPRM). The NPRM lays out the analytical and procedural framework that the FSOC proposes to use to determine whether a nonbank financial company could pose a threat to the financial stability of the U.S.

The NPRM sets forth a three-stage process by which nonbank financial companies generally will be assessed. The FSOC will apply uniform quantitative thresholds in stage 1, as described in the proposed interpretive guidance, to identify companies for further consideration. In stage 2, the FSOC will use information that is available from primary regulators and public information to further analyze the nonbank financial companies identified in stage 1. In stage 3, the FSOC will contact each nonbank financial company that the FSOC believes merits further review to collect information directly from the company that was not available in the earlier stages. At the end of stage 3, based on the results of the analyses conducted during each stage of review, the FSOC may vote to make a determination regarding the company. The comment period for the NPRM closes on December 19, 2011.

IV. Strengthening Capital, Leverage, and Liquidity Requirements

The financial crisis resulted in broad agreement to bolster the quality and quantity of capital held by financial institutions. The G20 has coordinated efforts by other international bodies, such as the Financial Stability Board and Basel Committee on Bank Supervision, to reach consensus on workable and effective enhanced standards. The OCC was actively involved in the development of these international standards through

its participation on the Basel Committee and is working with the other U.S. federal banking agencies to implement Dodd-Frank Act provisions relating to risk-based capital and leverage requirements in a manner that is consistent with those international standards.

In the U.S., the Dodd-Frank Act adds heightened prudential standards for all bank holding companies with more than $50 billion in assets and places floors under the risk-based capital requirements for banks and bank holding companies. In addition, Dodd-Frank requires all federal agencies to review any regulation that requires the use of an assessment of creditworthiness of a security or money market instrument and to remove any references to, or requirements of reliance on, credit ratings and substitute such standard of creditworthiness as each agency determines is appropriate. The statute further provides that the agencies shall seek to establish, to the extent feasible, uniform standards of creditworthiness, taking into account the entities the agencies regulate and the purposes for which those entities would rely on such standards.

The Basel Committee revisions that the OCC and the other federal banking agencies are working to implement in the U.S. include:

- A new, more rigorous definition of capital, which would exclude funds raised through hybrid instruments that were unable to absorb losses as the crisis deepened;
- Increased minimum risk-based capital requirements, which include increased minimum Tier 1 capital requirements and a new common equity requirement;

- The creation of a capital conservation "buffer" on top of regulatory minimums that would be designed to be drawn down in times of economic stress and would trigger restrictions on capital distributions (such as dividends);
- Enhanced risk-based capital requirements for counterparty credit risk that are meant to capture the risk that a counterparty in a complex financial transaction could grow weaker at precisely the time that a bank's exposure to the counterparty grows larger;
- Revisions to the capital requirements applicable to traded positions, which would broaden the scope of those rules to better capture risks not adequately addressed under the current regulatory measurement methodologies, including the risk that less liquid products, such as asset-backed securities and re-securitizations, could default or suffer severe losses;
- The creation of a new international leverage ratio requirement to serve as a backstop to the risk-based capital rules. Unlike the current U.S. leverage ratio, the international leverage ratio incorporates off-balance sheet exposures; and
- The adoption of a capital surcharge to be applied to a limited group of global, systemically important banks (G-SIBs), the failure of which would impose outsized costs on the financial system.

Basel III also seeks to address global liquidity concerns arising from the recent financial crisis. These changes would include both a short- and long-term liquidity standard intended to assist a bank in maintaining sufficient liquidity during periods of financial stress. The Basel Committee included a long implementation timeline for both standards to provide regulators the opportunity to conduct further analysis and to make

changes as necessary. The long-term standard, which is called the net stable funding ratio or NSFR, is not scheduled to become effective until 2018. The short-term requirement, the liquidity coverage ratio or LCR, is scheduled to go into effect earlier, in 2015. The federal banking agencies currently are working together to develop and recommend changes to the LCR to ensure that it will produce appropriate requirements and incentives, especially during economic downturns, and to otherwise limit potential unintended consequences.

Harmonizing the Dodd-Frank Act requirements with the revised international standards is one of the principal challenges the OCC and the other federal banking agencies will face. For example, under the Dodd-Frank Act, the FRB is required to develop and implement heightened prudential standards for bank holding companies with total consolidated assets over $50 billion, while the Basel Committee's G-SIB surcharge will, in all likelihood, apply to a much smaller subset of much larger banking institutions. In our discussions with the FRB, the OCC has stressed the need to ensure that the heightened prudential standards being developed, including liquidity, and the Basel Committee reforms are carried out in a coordinated, mutually reinforcing manner, so as to enhance the safety and soundness of the U.S. and global banking systems, while not damaging competitive equity or restricting access to credit. Balancing these interests presents a number of challenges that the agencies are continuing to work through.

The federal banking agencies expect to soon publish proposed revisions to their regulations for determining market risk capital requirements for traded positions. This will be the first risk-based capital proposal to incorporate new non-ratings based

alternatives developed in response to section 939A.[1] Interweaving all these national and international requirements, and meeting our statutory mandates and our commitments in Basel will be the challenge of the next 6-12 months.

V. Other Rulemakings

The OCC has issued a number of important proposed rules required under the Dodd-Frank Act. This portion of my testimony briefly highlights these proposals and discusses the key issues to be addressed in developing final rules.

Credit Risk Retention Rulemaking

Section 941 of the Dodd-Frank Act requires the OCC, together with the other federal banking agencies and the Department of Housing and Urban Development, the Federal Housing Finance Agency (FHFA), and the Securities and Exchange Commission (SEC), to require sponsors of asset-backed securities to retain at least five percent of the credit risk of the assets they securitize. The purpose of this new regulatory regime is to correct adverse market incentive structures by giving securitizers direct financial disincentives against packaging loans that are underwritten poorly.

Pursuant to this requirement, the interagency group issued a joint proposal. The proposal includes a number of options by which securitization sponsors could satisfy the statute's central requirement to retain at least five percent of the credit risk of securitized assets. This aspect of the proposal was designed to recognize that the securitization markets have evolved over time to foster liquidity in a variety of diverse credit products, using different types of securitization structures.

[1] In addition, on November 29, 2011 the OCC published a notice of proposed rulemaking seeking comment on revisions to its regulations pertaining to investment securities, securities offerings, and foreign bank capital equivalency deposits to replace references to credit ratings with alternative standards of creditworthiness. The comment period closes on December 29, 2011. 76 FR 73526.

The proposal would also establish certain exemptions from the risk retention requirement, most notably, an exemption for securitizations backed entirely by “qualified residential mortgages” (QRMs). Consistent with the statutory provision, the definition of QRM includes underwriting and product features that historical loan performance data indicate result in a low risk of default.

The proposal was published in the *Federal Register* on April 29, 2011, and comments were due by June 10, 2011. However, the agencies extended the comment period until August 1, 2011, due to the complexity of the rulemaking and to allow parties more time to consider the impact of the proposal.

The proposal generated substantial interest and attracted thousands of comments on a number of key issues from loan originators, securitizers, consumers, and policy makers. Foremost among these was the role of risk retention, the QRM exemption, and the future role of Fannie Mae and Freddie Mac in the residential mortgage market. Most commenters on the QRM criteria expressed great concern that the QRM criteria were too stringent, particularly the 80 percent loan-to-value requirement for purchase money mortgages. Some commenters also focused on the fact that the proposal would not directly alter the current risk retention practices of Fannie Mae and Freddie Mac, under which they retain 100 percent of the credit risk on their sponsored securitizations in the form of a guarantee and opposed the difference in treatment from private securitizers. Other commenters favored it in recognition of the market liquidity Fannie Mae and Freddie Mac presently provide. The proposed menu of risk retention alternatives also attracted significant comment, supporting the overall approach but also raising numerous specific concerns on the part of securitizers as to whether the particular options would

accommodate established structures for risk retention in differing types of securitization transactions.

The agencies are carefully evaluating all of the comments received and are now actively engaged in considering the many issues raised as we determine how best to proceed with the risk retention rulemaking.

Margin and Capital Requirements for Covered Swap Entities

During the financial crisis, the lack of transparency in derivatives transactions among dealer banks and between dealer banks and their counterparties created uncertainty about whether market participants were significantly exposed to the risk of a default by a swap counterparty. To address this uncertainty, sections 731 and 764 of the Dodd-Frank Act require the OCC, together with the FRB, Federal Deposit Insurance Corporation (FDIC), FHFA, and Farm Credit Administration (FCA), to impose minimum margin requirements on non-cleared derivatives.

Under the provisions of the Dodd-Frank Act, the OCC, together with the FRB, FDIC, FHFA, and FCA, published a proposal to establish minimum margin and capital requirements for registered swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants (swap entities) subject to agency supervision. The agencies proposed to require swap entities to collect margin for all uncleared transactions with other swap entities and with financial counterparties. However, for low-risk financial counterparties, the agencies proposed that swap entities would not be required to collect margin as long as its margin exposure to a particular low-risk financial counterparty does not exceed a specific threshold amount of margin. Consistent with the minimal risk that derivatives with commercial end users pose to the

safety and soundness of swap entities and the U.S. financial system, the proposal also included a margin threshold approach for these end users, with the swap entity setting a margin threshold for each commercial end user in light of the swap entity's assessment of credit risk of the end user. This approach was premised on current market practice, under which derivatives dealers view the question whether to require margin from commercial end users as a credit decision.

The proposal was published in the *Federal Register* on May 11, 2011, and comments were due June 24, 2011. However, due to the complexity of the rulemaking, to allow parties more time to consider the impact of the proposed rule, and so that the comment period on the proposed rule would run concurrently with the comment period for similar margin and capital requirements proposed by the Commodity Futures Trading Commission, the agencies extended the comment period until July 11, 2011.

With very limited exception, commenters strenuously opposed the agencies' proposed treatment of commercial end users. They urged the agencies to implement a categorical exemption, like the statutory exception from clearing requirements for commercial end users. They also indicated that the agencies' proposal on documentation of margin obligations was a departure from existing practice and burdensome to implement. They further indicated that, as drafted, the agencies' proposed threshold-based approach was inconsistent with the current credit assessment-based practices of swap entities.

Another key issue addressed by commenters concerns the proposal's application of margin requirements to foreign branches and affiliates of U.S. banks. The agencies requested comment about a number of specific issues surrounding this topic, including

whether it would affect competitive equality with foreign firms. Commenters also strenuously opposed this aspect of the proposal and indicated it would have a severe effect on their competitive position. These commenters noted that U.S. regulators are ahead of their G20 counterparts in formulating margin requirements, and imposition of U.S. margin rules on their foreign derivatives business at a time when their foreign competitors are not required to collect margin from their customers will effectively terminate this aspect of their business. They called for the agencies to delay imposition of this aspect of the proposal and work with foreign authorities to harmonize margin requirements internationally, phasing them in on a coordinated basis.

The agencies are carefully considering all of these issues as we proceed with the design of the rule.

Incentive Compensation Rulemaking

On April 14, 2011, the federal banking agencies, the National Credit Union Administration (NCUA), the SEC, and the FHFA issued a proposal to implement the incentive-based compensation provisions in Section 956 of the Dodd-Frank Act. The proposal applies to "covered financial institutions" (those with at least $1 billion in assets that offer incentive-based compensation) and has three main components: (1) a requirement that a "covered financial institution" disclose to its regulator the structure of its incentive-based compensation arrangements; (2) standards for incentive-based compensation that are comparable to the safety and soundness standards required under the Federal Deposit Insurance Act; and (3) a prohibition on incentive-based payment arrangements that encourage inappropriate risks by a covered financial institution by providing an executive officer, employee, director, or principal shareholder with

compensation that is excessive or that could lead to a material financial loss to the institution.

The material financial loss provision of the proposed rule establishes general requirements applicable to all covered institutions and additional requirements applicable to larger covered financial institutions (which for the federal banking agencies, NCUA, and the SEC means those covered financial institutions with total consolidated assets of $50 billion or more). The general requirements provide that an incentive-based compensation arrangement, or any feature of any such arrangement, established or maintained by any covered financial institution for one or more covered persons must balance risk and financial rewards and be compatible with effective controls and risk management and supported by strong corporate governance. For larger financial institutions, the proposed rule also mandates deferral and includes a provision concerning individuals who have the ability to expose the institution to possible substantial losses (so called "material risk takers"). These institutions must defer 50 percent of incentive-based compensation for executive officers for at least three years, and their boards of directors must identify, and approve, the incentive-based compensation arrangements for material risk takers.

The comment period on the proposed rule closed on May 31, 2011, and the agencies collectively received thousands of comments – approximately 9,700 comments were received by the OCC alone. Among the major issues the agencies are facing are whether to continue to mandate deferral as proposed and whether to revise the material risk taker provision to more clearly delineate the individuals encompassed by the provision and the board of director's responsibilities with respect to these individuals.

Volcker Rule Proposal

On November 7, 2011, the banking agencies and the SEC jointly published a proposal to implement section 619 of Dodd-Frank, also known as the Volcker Rule. Section 619 prohibits "banking entities" (insured depository institutions and any company that controls an insured depository institution) from engaging in proprietary trading and from acquiring or retaining an ownership interest in, sponsoring, or entering into certain relationships with hedge funds and private equity funds. Section 619 expressly exempts certain permitted activities from these prohibitions, including trading in certain government obligations, underwriting, market-making-related activities, risk-mitigating hedging, trading on behalf of customers, public welfare investments, organizing and offering funds for trust, fiduciary and advisory customers, and trading and fund activities solely outside of the U.S. All permitted activities are subject to statutory backstops, regardless of the size of the institution involved, and compliance program requirements may apply as well.

The proposal is the result of months of intensive study and analysis by the agencies of the statutory language of section 619, its legislative history, the FSOC report on the implementation of the Volcker Rule, existing regulatory guidance, and the business practices of banking entities covered by the rule.

The proposal implements the statutory prohibitions and restrictions on proprietary trading and covered fund activities and investments, the related statutory exemptions for permitted activities, and the statutory backstops that apply to all permitted activities. The proposal establishes requirements for engaging in the statutorily permitted activities and interprets many of the exceptions conservatively, including, in particular, the exceptions

for underwriting, market-making-related activities, and risk-mitigating hedging. The proposal also defines two key statutory backstops: the prohibitions on engaging in an activity that would involve or result in either a material conflict of interest between the banking entity and its customers, or in a material exposure by the banking entity to a high-risk asset or trading strategy. Banking entities with significant trading activities also are required to report quantitative metrics to help evaluate the extent to which these activities are consistent with permissible market-making-related activities and whether they expose the institution to high-risk assets or trading strategies.

The proposal further requires banking entities engaged in proprietary trading and covered fund activities and investments to develop and implement a compliance program that must address internal policies and procedures, internal controls, a management framework, independent testing, training, and making and keeping of records. The extent of these requirements escalates depending on the volume of the activity. Banking entities with significant trading or covered fund activities or investments must adopt a more detailed compliance program. Banking entities that solely are engaged in activities or in making investments that are permissible under the proposal will still need to satisfy certain compliance requirements designed to assure that their activities are permissible and do not violate any of the statutory backstop standards. Banking entities that do not engage in activities or make investments that are prohibited or restricted by the proposal must also put in place policies and procedures that are designed to prevent them from becoming engaged in such activities or from making such investments without establishing a compliance program required by the proposal.

The proposed rule is open for public comment through January 13, 2012.

Cost-Benefit Analysis

The OCC recognizes the importance of considering the burdens associated with approaches to implementation of Dodd-Frank Act regulatory requirements and the impact of different approaches on smaller institutions. In conjunction with all its rulemakings, the OCC is subject to several standards that require the agency to consider the costs and burdens of the proposed regulation. Since the Committee's last hearing, the Department of the Treasury's Office of Inspector General (IG) completed its review, done at the request of the Ranking Member and other Members of this Committee, of OCC's processes for performing economic analyses in support of our rulemakings and how those processes considered the costs, benefits, and economic impact of certain proposed rules promulgated as a result of the Dodd-Frank Act. On June 13, 2011, the IG issued an informational report on the economic analyses performed by the OCC with respect to three proposed rules. Among other findings, the IG report concluded that "OCC has processes in place to ensure that required economic analyses are performed consistently and with rigor in connection with its rulemaking authority. Furthermore, we found that those processes were followed for the three proposed rules we reviewed."

The OCC conducts analyses to determine the effects and impact of its regulations in accordance with the following three key statutes: the Unfunded Mandates Reform Act, the Congressional Review Act, and the Regulatory Flexibility Act.

Consistent with the Unfunded Mandates Reform Act,[2] the OCC prepares a written statement containing certain information and analysis specified in the statute if a rule contains a federal mandate that may result in the expenditure by state, local, and tribal

[2] 2 U.S.C. §§ 1501 *et seq*.

governments, in the aggregate, or by the private sector, of $100 million or more in any one year.

The Congressional Review Act,[3] generally provides a mechanism for Congressional review of agency regulations by requiring agencies to report to Congress and the General Accountability Office (GAO) when they issue a final rule and by establishing time frames within which Congress may act to disapprove a rule. The statute requires the Office of Management and Budget (OMB) to determine whether the final rule is a major rule for purposes of filing a report to Congress (Report to Congress); the OCC provides its views to OMB for consideration as the determination is made. Once this determination is made, the OCC must submit to Congress and the GAO a Report to Congress. As part of the Report to Congress, the OCC must state whether the rule is a "major rule" for Congressional Review Act purposes and must indicate whether the OCC prepared an analysis of costs and benefits.

Finally, with certain exceptions, the Regulatory Flexibility Act[4] generally requires the OCC to review proposed regulations for their impact on small entities and, in certain cases, to consider less burdensome alternatives. After conducting this review, the OCC is required either to prepare and publish a Regulatory Flexibility Analysis or to certify that a Regulatory Flexibility Analysis is not required because the rule will not have a "significant economic impact on a substantial number of small entities."

The OCC also recently responded to a letter from Chairman Johnson requesting, among other things, a description of the OCC's rulemaking process and the economic impact factors considered in OCC rulemakings. Our response to that request includes

---

[3] 5 U.S.C. §§ 801 *et seq*.
[4] 5 U.S.C. §§ 601 *et seq*.

more detailed information about the procedures staff uses to assess the economic impact in accordance with the statutes described above.

VI. Conclusion

I appreciate the opportunity to update the Committee on the work we have done to implement the provisions of the Dodd-Frank Act, in particular, the completion of a smooth and workable integration of the OTS into the OCC and our progress on the numerous regulatory projects that are ongoing. Much has been accomplished and we will continue to move forward to complete these projects and look forward to keeping the Committee advised of our progress. I am happy to answer your questions.