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TESTIMONY OF

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COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

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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 Crapo, and members of the Committee, thank you for the opportunity to update you on steps the Office of the Comptroller of the Currency (OCC) has taken to enhance the effectiveness of our supervision and the status of our efforts to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act). The OCC is the primary regulator of nearly 1,650 national banks and federal savings associations with approximately $10.5 trillion in assets, which represents 68 percent of all bank and thrift assets insured by the Federal Deposit Insurance Corporation (FDIC).[1] OCC-supervised banks and thrifts hold the majority of FDIC-insured deposits and range from small, community banks with assets of less than $100 million to some of the largest and most complex financial institutions.

Our nation's economic and financial condition has steadily improved since the financial crisis, and the strength and health of our federal banking system reflect this progress. As a bank supervisor, I take comfort in these improvements. I am keenly aware, however, that we need to remain vigilant, and I am instituting new measures to ensure we do so. Specifically, the OCC is recalibrating the way we supervise large, complex financial institutions based on the lessons we have learned since the financial crisis. Importantly, we are strengthening our capacity to take a broad, horizontal view across the institutions we regulate to identify emerging trends and red flags, while enhancing our traditional hands-on supervision of individual institutions. In addition, we are requiring our largest institutions to improve risk management and corporate governance.

In my testimony today, I will address recent OCC initiatives that are central to the effective and vigilant oversight of national banks and federal savings associations. Additionally, in response to the Committee's letter of invitation, I will discuss the OCC's progress in issuing

[1] All data are as of June 30, 2014.

and implementing the rules required by the Dodd-Frank Act, as well as the OCC's efforts to coordinate our supervision with other domestic and international regulators. Finally, my testimony will touch on emerging issues related to cybersecurity.

I. State of the National Banking and Federal Thrift System

The condition of the national banks and federal savings associations that the OCC supervises (collectively referred to here as "banks") has steadily improved over the past four years, as the economy has slowly recovered from the severe 2008-2009 credit crisis and recession. Banks have increased their total lending volume during this period, although this increase is at a pace below the long-term average rate of growth. Total credit growth has been subdued, primarily due to an extended contraction in residential mortgage activity, with only recent signs of emerging loan growth in this area. Private residential mortgage securitization has yet to recover.

Although housing credit has continued to struggle, other areas of loan growth have shown more resilience. For example, commercial and industrial loan growth has averaged 10 percent per year during the past four years, triple its average pace in the decade before the financial crisis. Auto sales and lending also have rebounded from the lows of the recession and are fast approaching pre-crisis levels. Credit quality has significantly improved. Charge-off rates for all major loan categories are at or below the 25-year average and, as a result, the federal banking system's total loan charge-off rate is now 0.6 percent, 40 percent below the 25-year average of 1 percent. The ratio of loan loss reserves to total loans, a measure of a bank's expectation of future loan losses, has returned to its 1984-2006 average of below 2 percent, after peaking at 4 percent in 2010. That said, concerns have begun to emerge related to subprime auto lending outside the banking system and to loan terms more generally. Leveraged lending also has grown rapidly,

and the OCC, along with the other federal banking agencies, issued guidance aimed at preventing overheating in this area.

Given the gradual recovery in lending and improved credit performance, the profitability of the federal banking system has steadily improved, from a 7 percent return on equity in 2010 to approximately 10 percent today. However, the return on assets is approximately 1.1 percent, and profitability levels remain subdued relative to the pre-crisis period. This is due in part to a continued low level of loans to total assets and the narrow lending margins that result from persistently low interest rates, as well as elevated expenses tied to enhanced compliance and ongoing litigation costs. Even so, the proportion of unprofitable banks is at 8.9 percent, just above the 8 percent average in the decade prior to the crisis and well down from a peak of nearly one-in-three at the height of the crisis.

The number of troubled institutions supervised by the OCC (CAMELS 4 or 5 rated) has decreased significantly, from a high of 196 in December 2010, to 77 in June of this year. Bank balance sheets also reflect stronger capital and improved liquidity. Tier 1 common equity stands at nearly 13 percent of risk-weighted assets, up from a low of 9 percent in the fall of 2008. The current capital leverage ratio is now at 9.3 percent, 40 percent above the ratio in 2008. Liquid assets have achieved a thirty-year high of 15 percent of total assets.

II. Enhancing Supervision

The financial crisis underscored the critical role of supervision in ensuring a safe and sound global banking system as well as the need to change supervisory approaches that may not have kept pace with developments in the industry. Key lessons from both the crisis and the international supervisory peer review study that we commissioned prompted the OCC to reassess and revise our supervisory approach for all banks, particularly larger banks. Below, I describe

OCC initiatives in this area that will transform how we supervise both larger institutions and the small institutions whose vitality is critical to so many communities across our country.

A. New Supervisory Initiatives

In 2013, I asked a team of international regulators (referred to here as the "peer review team") to provide the OCC with a candid and independent assessment of our supervision of midsize and large banks. The scope of the assessment was broad: it included how we go about the business of supervision; our agency culture and approach to risk identification; and any gaps in our supervisory approach or systems.

While the peer review team complimented many areas of OCC supervision, it also identified areas where the OCC can improve: enhancing systemic risk monitoring and the processes that support supervisory responses; improving the consistency of supervisory practices within and across business lines; and strengthening the standards we use to supervise. In the months since the peer review team's report,[2] the OCC has taken steps to improve our supervisory processes and execute plans based on the report's findings that include a number of transformational improvements, which I describe below.

Remaking the Large Bank Lead Expert Program

We are expanding and restructuring the organization, functions, and responsibilities of our Large Bank Lead Expert Program in which an expert, independent of the dedicated examination staff, is assigned to each key risk area. This expansion will allow us to compare the operations of the institutions we regulate and improve our ability to identify systemic risk. It will also enhance the quality control of our exam processes and enable us to allocate our resources more effectively. In addition, we are making a number of changes to our dedicated

[2] http://www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-184.html.

examiner program and implementing a rotation policy to enhance the skills and broaden the perspectives of our examination teams.

Enhancing Risk Monitoring

The OCC's supervisory program includes our National Risk Committee (NRC), which monitors the condition of the federal banking system and emerging threats to the system's safety and soundness. The NRC meets quarterly and issues guidance to examiners providing important perspectives on industry trends and highlighting issues requiring supervisory attention. This information allows the OCC to react more quickly to emerging risks and trends and to allocate our resources in a manner that matches the challenges we are likely to face going forward.

In addition, using midyear and year-end data, the NRC publishes the Semiannual Risk Perspective report, which informs the development of our supervisory strategies and processes. We make this report available to the public. The broad dissemination of this information is part of our continuing efforts to provide greater transparency to both the public and industry regarding the issues to which we are devoting increased supervisory attention. In June 2014, the report also began outlining our key supervisory priorities for the next twelve months both for large bank supervision and for midsize and community bank supervision.

Other analytical groups that focus on specific risk areas, such as retail and commercial credit and conditions across our districts, support the work of the NRC. We recently augmented the existing risk committees with a Large Bank Supervision Risk Committee (LBSRC). The LBSRC will further enhance our ability to identify and respond quickly to emerging risk issues across large, complex institutions, ensure consistency in our supervisory activities, and assist the NRC in its risk monitoring activities.

Improving Management Information Systems and Data Analytics

The OCC has unique and secure access to substantial and comprehensive banking system data, and it is imperative that we have strong data analytics. Our goal is to transition to a shared services environment across functions within the agency to improve the ability of our supervisory staff to use this data and enhance the integrity and consistency of our data analytics. These changes will improve the consistency, reliability, and efficiency of our supervision of the institutions that we oversee.

Formalizing an Enterprise Risk Management Framework

The OCC sets a high bar for the institutions we supervise, and we must ask no less of ourselves. To this end, we are developing and formalizing an enterprise risk management framework for the OCC, including a risk appetite statement, to better define, measure, and control the risks that we accept in pursuit of our mission, vision, and strategic goals. A working group will soon conduct an initial enterprise-wide risk assessment and inventory existing risk management practices.

B. <u>Heightened Standards for Large Banks</u>

Due to their size, activities, and implications for the U.S. financial system, large institutions require more rigorous regulation and supervision than less systemically significant institutions. Since the crisis, we have applied heightened standards to large institutions. These standards address comprehensive and effective risk management; the need for an engaged board of directors that exercises independent judgment; the need for a robust audit function; the importance of talent development, recruitment, and succession planning; and a compensation structure that does not encourage inappropriate risk taking.

Last week, we issued final guidelines refining and formalizing these standards and making them enforceable. These standards provide important additional supervisory tools to examiners and focus bank management and boards of directors on strengthening their institutions' risk management practices and governance. The standards are generally applicable to insured national banks, insured federal savings associations, and insured federal branches of foreign banks with average total consolidated assets of $50 billion or greater (referred to in this subsection as "banks").

The final guidelines set forth minimum standards for the design and implementation of a bank's risk governance framework and provide minimum standards for the board's oversight of the framework. The standards make clear that the framework should address all risks to a bank's earnings, capital, and liquidity that arise from the bank's activities.

The standards also set out roles and responsibilities for the organizational units that are fundamental to the design and implementation of the risk governance framework. These units, often referred to as a bank's three lines of defense, are front line business units, independent risk management, and internal audit. The standards state that, together, these units should establish an appropriate system to control risk taking. The standards also provide that banks should develop a risk appetite statement that articulates the aggregate level and types of risk a bank is willing to assume to achieve its strategic objectives, consistent with applicable capital, liquidity, and other regulatory requirements.

In addition, the final guidelines contain standards for boards of directors regarding oversight of the design and implementation of a bank's risk governance framework. They note that it is vitally important for each director to be engaged in order to understand the risks that his or her institution is taking and to ensure that those risks are well-managed. Directors should be

in a position to present a credible challenge to bank management with the goal of preserving the sanctity of the bank's charter. That is, a bank should not be treated merely as a booking entity for a holding company. The federal bank charter is a special corporate franchise that provides a gateway to federal deposit insurance and access to the discount window. Accordingly, management and independent directors must see that the bank operates in a safe and sound manner.

We issued the final standards as a new appendix to Part 30 of our regulations. Part 30 codifies an enforcement process set out in the Federal Deposit Insurance Act that authorizes the OCC to prescribe operational and managerial standards. If a bank fails to satisfy a standard, the OCC may require it to submit a compliance plan detailing how it will correct the deficiencies and how long it will take. The OCC can issue an enforceable order if the bank fails to submit an acceptable compliance plan or fails in any material way to implement an OCC-approved plan.

Higher supervisory standards for the large banks we oversee, such as those in the final guidelines, along with bank management's implementation of these standards, are consistent with the Dodd-Frank Act's broad objective of strengthening the stability of the financial system. We believe that this increased focus on strong risk management and corporate governance will help banks maintain the balance sheet improvements achieved since the financial crisis and make them better able to withstand the impact of future crises.

C. Supervision of Community Banks

The OCC is the supervisor of approximately 1,400 institutions with assets under $1 billion, of which approximately 870 have less than $250 million in assets. These small institutions play a vital role in our country's financial system by providing essential products and

services to our communities and businesses, including credit that is critical to economic growth and job creation.

The OCC is a resource to these community banks through our more than 60 offices throughout the United States. Our examiners are part of the communities in which they work and are empowered to make most supervisory decisions at the local level. In addition, the entire agency works to support these examiners and small banks and provides them with easy access to licensing specialists, lawyers, compliance and information technology specialists, and a variety of other subject matter experts.

Small banks face unique challenges, and the OCC has been sensitive to this in our implementation of the Dodd-Frank Act and in our approach to supervising these institutions. Throughout the rulemaking process, the agency has sought and listened to comments and concerns from community banks. We have heard – and we agree – that a one-size-fits-all approach to bank supervision is not appropriate. Accordingly, we tailor our supervisory programs to the risk and complexity of a bank's activities and have separate lines of business for community and midsize banks and large banks. When developing regulations, the OCC works to avoid unnecessary regulatory and compliance burden on small banks.

Our commitment to this principle is evident in many of the rules we have issued. For example, the lending limits rule we issued under the Dodd-Frank Act provides a simpler option that small banks may use for measuring the credit exposure of derivative and securities financing transactions. The final domestic capital rules, issued on an interagency basis, also accommodate concerns of small banks with respect to the treatment of trust preferred securities (TruPS), accumulated other comprehensive income, and residential mortgages. Finally, with our interagency counterparts, we revised the treatment of certain collateralized debt obligations

(CDOs) backed primarily by TruPS under the Volcker Rule largely to address concerns raised by community banks.

The OCC, along with the other federal banking agencies, is also engaged in a review of regulatory burden pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). This statute requires the OCC, as well as the FDIC and Board of Governors of the Federal Reserve System (FRB), to seek public comment at least once every 10 years to identify outdated, unnecessary, or unduly burdensome regulations. The EGRPRA review provides the public with an opportunity to recommend to the agencies how to reduce burden through targeted regulatory changes.

In connection with the EGRPRA process, the agencies published a *Federal Register* notice this past June asking for comment on three categories of rules. The comment period on this first notice ended one week ago, and the agencies are reviewing the comments received. Over the next two years, the agencies will issue three more *Federal Register* notices that will invite public comment on the remaining rules. In each notice, we will specifically ask the public, including small institutions, to identify ways to reduce unnecessary burden associated with our regulations.

The OCC also has taken steps to communicate more effectively with the small banks we supervise. Certain provisions of the Dodd-Frank Act apply to institutions of all sizes, but many apply only to larger banks. Therefore, in each bulletin transmitting a new regulation or supervisory guidance to our banks, we include both a "highlights section" that succinctly summarizes the major provisions of the issuance and an easy-to-see box written in plain English that allows community banks to assess quickly whether the issuance applies to them. We have also developed other methods for distilling complex requirements, such as summaries and guides

that highlight aspects of rules that are relevant to small institutions. We have received positive feedback on these communication tools, and we will continue to work to make the regulatory process manageable for small banks.

III. Dodd-Frank Act: Regulatory Milestones Achieved

Congress enacted the Dodd-Frank Act to address regulatory gaps, create a stronger financial system, and address systemic issues that contributed to, or that accentuated and amplified the effects of, the financial crisis. To achieve these objectives, the Act provided the federal financial regulators, including the OCC, with new tools to address risk and to mitigate future financial crises.

The implementation of the Dodd-Frank Act presented challenges on an unprecedented scale, as many of these new tools required, among other things, the federal financial regulators to write or revise a number of highly complex regulations. In the four years since the Act became law, the OCC has worked tirelessly to fulfill this mandate. I am pleased to report that the OCC has completed all rules that we have independent authority to issue. Furthermore, the OCC has finalized many of the regulations that the Dodd-Frank Act required the OCC to issue jointly or on a coordinated basis with other federal financial regulators. For those rulemakings that remain, we have made good progress and, in many cases, we have seen meaningful improvements in industry practices in anticipation of the finalized rules. Below, I will discuss the completed rulemakings followed by a description of the rulemakings that are in-process.

A. Finalized Rules

OCC/OTS Integration

The Dodd-Frank Act transferred to the OCC all the functions of the Office of Thrift Supervision (OTS) relating to federal savings associations, as well as the responsibility for the

examination, supervision, and regulation of federal savings associations. We have previously reported on the successful transfer of these functions, including the integration into the OCC of former OTS employees and systems and the development of an aggressive cross-credentialing program that qualifies examiners to lead examinations of both national banks and federal savings associations.

We are committed to continuing to improve and refine our new responsibilities. For example, we are undertaking a comprehensive, multi-phase review of our regulations and those of the former OTS to reduce regulatory burden and duplication, promote fairness in supervision, and create efficiencies for both types of institutions. We have begun this process and, in June of this year, we issued a proposal to integrate national bank and federal saving association rules relating to corporate activities and transactions.

In addition, as we have gained experience in our supervision of federal savings associations, I have come to recognize that the current legal framework limits the ability of these institutions to adapt their business strategies to changing economic and business environments unless they change their charter or business plans. More specifically, federal savings associations that want to move from a mortgage lending business model to providing a mix of business loans and consumer credit would need to change charters. I believe that the thrift charter should be flexible enough to accommodate either strategy.

When I was a regulator in Massachusetts, we made state bank and thrift powers and investment authorities, as well as supervisory requirements, the same or comparable regardless of charters, and we allowed the institutions to exercise those powers while retaining their own corporate structure. Congress may wish to consider authorizing a similar system at the federal

level. This flexibility will improve the ability of thrifts to meet the financial needs of their communities.

The "Volcker Rule"

On December 10, 2013, the OCC, jointly with the FDIC, FRB, and the Securities and Exchange Commission (SEC), adopted final regulations implementing the requirements of section 619, also known as the "Volcker Rule."[3] Section 619 prohibits a banking entity from engaging in short-term proprietary trading of financial instruments and from owning, sponsoring, or having certain relationships with hedge funds or private equity funds (referred to here and in the final regulations as "covered funds"). Notwithstanding these prohibitions, section 619 permits certain financial activities, including market making, underwriting, risk-mitigating hedging, trading in government obligations, and organizing and offering a covered fund.

In accordance with the statute, the final regulations prohibit banking entities from engaging in impermissible proprietary trading and strictly limit their ability to invest in covered funds. At the same time, the regulations are designed to preserve market liquidity and allow banks to continue to provide important client-oriented services. As discussed later in this testimony, the OCC and the other agencies are currently working together to implement this rulemaking.

The agencies followed this rulemaking with an interagency interim final rule to permit banking entities to retain interests in certain CDOs backed primarily by TruPS. We issued this interim rule because of, and in response to, concerns expressed primarily by small institutions that they would otherwise have to divest instruments that the Dodd-Frank Act expressly allows for capital-raising purposes.

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[3] The Commodity Futures Trading Commission (CFTC) issued a separate rule adopting the same common rule text and a substantially similar preamble.

Annual Stress Tests

This OCC-only rule, issued on October 9, 2012, implements section 165(i)(2) of the Act by requiring banks with average total consolidated assets of $10 billion or greater to conduct annual "stress tests." The rule, which is consistent with and comparable to the stress test rules issued by the other federal banking agencies, establishes methods for conducting stress tests, requiring that the tests be based on at least three different economic scenarios (baseline, adverse, and severely adverse). The rule also sets forth the form and content for reporting the test results and requires banks to publish a summary of the results. In addition, the rule divides banks into two categories, based on asset size, so that those with total consolidated assets between $10 and $50 billion and those with assets over $50 billion are subject to different test requirements, as well as reporting and disclosure deadlines.

Lending Limits

The OCC issued a final rule on June 25, 2013, implementing section 610 of the Act, which amended the national bank statutory lending limit at 12 U.S.C. 84. The rule revises the lending limits applicable to banks to include credit exposures arising from derivative transactions, as well as repurchase agreements, reverse repurchase agreements, securities lending transactions, and securities borrowing transactions.

Appraisals for Higher-Priced Mortgage Loans

On January 18, 2013, the OCC participated in the issuance of an interagency rule concerning appraisals for "higher-priced mortgage loans," which are loans secured by a consumer's home with interest rates above certain thresholds. The rule requires that creditors for higher-priced loans obtain appraisals that meet certain standards, notify loan applicants of the purpose of the appraisal, and give applicants for certain higher-priced mortgages a copy of the

appraisal before advancing credit. In addition, if the seller acquired the property for a lower price during the six months before the sale and the price difference exceeds a certain threshold, a creditor must obtain a second appraisal at no cost to the consumer. This requirement for higher-priced home-purchase mortgage loans seeks to address fraudulent property flipping by ensuring that the property value increase was legitimate.

Collins Amendment

The OCC participated with the FDIC and FRB in issuing an interagency rule on June 11, 2011, that established a floor for the risk-based capital requirements applicable to the largest, internationally active banking organizations. This rule amended the advanced risk-based capital adequacy standards (the "advanced approaches rules") consistent with section 171(b) of the Act, known as the "Collins Amendment." Under the rule, a banking organization that has received approval to use the advanced approaches rules is required to meet the higher of the minimum requirements under the general risk-based capital rules or the minimum requirements under the advanced approaches rules.

Alternatives to External Credit Ratings

On June 13, 2012, the OCC published a rule implementing sections 939 and 939A of the Act. This rule removes references to external credit ratings from the OCC's non-capital regulations, including its regulation that sets forth the types of investment securities that banks may purchase, sell, deal in, underwrite, and hold. Banks must conduct their own analysis of whether a security is investment grade. In addition, the OCC, together with the other federal banking agencies, removed all references to external credit ratings from their risk-based capital rules when we finalized the enhanced capital rule on October 11, 2013 (discussed below). For

example, for securitization positions, the enhanced capital rule replaced a ratings-based approach with a non-ratings-based supervisory formula for determining risk-based capital requirements.

B. Rules In-Process

Swaps Margin Rule

The OCC, jointly with the FDIC, FRB, Federal Housing Finance Agency (FHFA), and Farm Credit Administration, published a proposal in 2011 to implement sections 731 and 764 of the Act by requiring covered swap entities to collect margin for their non-cleared swaps and non-cleared security-based swaps. Subsequently, the OCC, FDIC, and FRB participated in international efforts to coordinate the implementation of margin requirements among the G-20 nations. Following extensive public review and comment, the Basel Committee on Bank Supervision (Basel Committee) and the International Organization of Securities Commissions finalized an international framework in September of last year.

After considering the international framework and the comments we received on the U.S. proposal, the agencies decided to re-propose the U.S. swaps margin rule. I am happy to report that last week I signed an interagency re-proposal that imposes minimum initial margin and variation requirements for certain non-cleared swaps and security-based swaps. The re-proposal specifically seeks to avoid unnecessarily burdening both non-financial entities that use swap contracts to hedge commercial costs and smaller financial companies whose activities do not pose a risk to the financial system. The rule would reduce risk, increase transparency, and promote market integrity within the financial system by addressing the weaknesses in the regulation and structure of the swaps markets that the financial crisis revealed. The comment period on this re-proposal is open for 60 days but, as previously noted in the OCC's Quarterly

Report on Bank Trading and Derivatives Activities, we have already seen improvements in the overall collateralization rates for industry derivative exposures.

Credit Risk Retention

The OCC participated in the issuance of an interagency proposal in 2011 that established asset-backed securities requirements designed to motivate sponsors of securitization transactions to exercise due diligence regarding the quality of the loans they securitize. Under this proposal, a securitizer would have to retain a material economic interest in the credit risk of any asset that it transferred, sold, or conveyed to a third party. The agencies received over 10,000 comments on the proposal and concluded that the rulemaking would benefit from a second round of public review and comment.

In September 2013, the interagency group issued a re-proposal. Although the re-proposal includes significant changes from the original, its focus is the same — to ensure that sponsors are held accountable for the performance of the assets they securitize. The OCC and the other participating agencies expect to approve the final rule in the near future.

Incentive-Based Compensation Arrangements

The OCC, together with the FRB, FDIC, OTS, National Credit Union Administration, SEC, and FHFA, published a proposal on April 14, 2011, designed to ensure that certain financial institutions with more than $1 billion in assets structure their incentive compensation arrangements: (1) to balance risk and financial rewards; (2) to be compatible with effective controls and risk management; and (3) to be supported by strong corporate governance. Specifically, the proposal, which would implement section 956 of the Act, would require these institutions to report incentive-based compensation arrangements and prohibit arrangements that either provide excessive compensation or could expose an institution to inappropriate risks that

could lead to material financial loss. In light of the thousands of comments that the agencies received on the proposal, as well as significant industry and international developments related to incentive-based compensation, the agencies continue to work on the rule. The completion of this rule is an OCC priority because of the impact that poorly structured incentive compensation can have on risk-taking behaviors and the overall safety and soundness of an institution. Finalizing this rule will reinforce and complement the risk management principles and heightened standards that we are implementing.

Retail Foreign Exchange Transactions

On July 14, 2011, the OCC issued a final retail foreign exchange transactions rule for OCC-regulated entities that engage in off-exchange transactions in foreign currency with retail customers, implementing section 742(c)(2) of the Act. The rule contains a variety of consumer protections, including margin requirements, required disclosures, and business conduct standards, on foreign exchange options, futures, and futures-like transactions with certain retail customers. To promote regulatory comparability, the OCC worked closely with the CFTC, SEC, FDIC, and FRB in developing this rule. On October 12, 2012, the OCC issued a proposal to amend this final rule in light of related CFTC and SEC rules, and we continue to work on finalizing this proposal.

Appraisal Management Companies

In April 2014, the OCC joined in the issuance of an interagency proposal to implement section 1473 of the Act, which sets forth minimum requirements for state registration and supervision of appraisal management companies (AMCs). (AMCs serve as intermediaries between appraisers and lenders and provide appraisal management services). The proposal:

(1) provides that AMC-coordinated appraisals must adhere to applicable quality control standards; (2) facilitates state oversight of AMCs; and (3) ensures that states report to the Federal Financial Institutions Examination Council's (FFIEC) Appraisal Subcommittee the information needed to administer a national AMC registry. The agencies plan to issue a final rule in the near term.

Source of Strength

The OCC, FRB, and FDIC continue to work on an interagency basis to draft a proposal to implement section 616(d) of the Act to require bank and savings and loan holding companies, as well as other companies that control depository institutions, to serve as a "source of strength" for their subsidiary depository institutions. As we saw during the crisis, too often banks served as a source of strength for non-bank subsidiaries of their holding companies. This rulemaking will complement actions we have taken elsewhere to preserve the federally insured bank's financial health.

IV. Other Significant OCC Rulemaking Projects

The OCC, together with the FRB and FDIC, has proposed or finalized a number of other significant rules over the past four years. Many of these rules, although not mandated by the Dodd-Frank Act, share the same broad objectives and address many of the same concerns as the Act. Several of these rules result from international initiatives by groups such as the Basel Committee and, consistent with the Dodd-Frank Act, are intended to strengthen global capital and liquidity requirements and promote a more resilient banking sector. I describe these rules below.

Enhanced Liquidity Standards

On September 3, 2014, the OCC, FDIC, and FRB approved a final rule to implement the Basel Committee's liquidity coverage ratio in the United States. These standards address banking organizations' maintenance of sufficient liquidity during periods of acute short-term financial distress. Under the rule, large, internationally active banking organizations[4] are required to hold an amount of high quality liquid assets to cover 100 percent of their total net cash outflows over a prospective 30 calendar-day period.

The agencies are also working with the Basel Committee to develop a net stable funding ratio, which is intended to complement the liquidity funding ratio by enhancing long-term structural funding. It is expected that these liquidity standards, once fully implemented, will accompany the existing liquidity risk guidance and enhanced liquidity standards (issued by the FRB in consultation with the OCC and the FDIC) that are part of the heightened prudential standards required by section 165 of the Dodd-Frank Act.

Enhanced Capital Rule

Last year, the OCC, FDIC, and FRB issued a rule that comprehensively revises U.S. capital standards. Most revisions, including the narrowing of instruments that count as regulatory capital, will be phased in over several years. For large, internationally active banking organizations, this phase-in has already begun. For all other banks, the phase-in will begin in 2015.

The Basel Committee's efforts to revise the international capital framework shared many of the goals of the Dodd-Frank Act and addressed many of the same issues. For example, both the agencies' enhanced capital rule and the Dodd-Frank Act focus increased attention on efforts

[4] This category of institutions is defined as those with $250 billion or more in total consolidated assets or $10 billion or more in foreign financial exposure.

to address the excessive interconnectedness of financial sector exposures and to create incentives for the use of central clearing houses for over-the-counter derivatives. This capital rule and the Dodd-Frank Act require an improvement in the quality and consistency of regulatory capital by narrowing the instruments that count as regulatory capital. Furthermore, the enhanced capital rule establishes conservative, stringent capital standards, especially for large banking organizations, by increasing overall risk-based capital requirements and refining the methodologies for determining risk-weighted assets to better capture risk.

Supplementary Leverage Ratio

Regulatory capital standards in the U.S. have long included both risk-based capital and leverage ratio requirements. The Basel Committee's revisions to the international capital framework introduced a new leverage ratio requirement for large, internationally active banking organizations. The federal banking agencies' supplementary leverage ratio implements this additional and stricter leverage requirement. Unlike the more broadly applicable leverage ratio, this supplementary leverage ratio adds off-balance sheet exposures into the measure of total leverage exposure (the denominator of the leverage ratio). The supplementary leverage ratio is a more demanding standard because large banking organizations often have significant off-balance sheet exposures arising from different types of commitments, derivatives, and other activities.

Earlier this year, to further strengthen the resilience of the banking sector, the federal banking agencies finalized a rule that enhances the supplementary leverage ratio requirement for the largest, most systemically important U.S. banking organizations (those with $700 billion or more in total consolidated assets or $10 trillion or more in assets under custody). Under this rule, these banking organizations will be required to maintain even more Tier 1 capital for every dollar of exposure in order to be deemed "well capitalized."

Last week, the OCC and other federal banking agencies approved a final rule that further strengthens the supplementary leverage ratio by more appropriately capturing a banking organization's potential exposures. In particular, the revisions contained in this final rule will better capture leverage embedded in a bank's buying and selling of credit protection through credit derivatives. This should further improve our assessment of leverage at the largest banks that are the most involved in the credit derivatives business.

V. Coordination with Domestic and International Regulators

The Committee has also asked us to report on the OCC's efforts to better coordinate with other domestic and international regulators. The OCC, FDIC, and FRB have a long history of cooperative and productive relationships, through a combination of formal agreements, informal working groups, and the FFIEC. For example, although the OCC, FDIC, and FRB each has its own infrastructure, focus, and responsibilities, we work together to foster a coordinated and cohesive supervisory approach that minimizes overlaps and avoids supervisory gaps. This allows each agency to deploy its resources effectively and leverage supervisory work products. It also allows for the timely communication of supervisory risks, concerns, priorities, and systemic information, while reducing the supervisory burden on our institutions and the agencies. In addition, I am very pleased to report that the OCC and SEC recently signed a Memorandum of Understanding to facilitate sharing and coordination between our two agencies.

We have extended this network to include collaboration with the Bureau of Consumer Financial Protection (CFPB) and state banking regulators. For example, we have protocols in place to share information with the CFPB, and we work together to schedule exams and coordinate other supervisory activities. In addition, the OCC is engaged in the Financial Stability Oversight Council, which the Dodd-Frank Act established to help identify and respond

to emerging risks across the financial system. Together, these relationships allow agencies to share and compare insights and expertise and to reduce duplication.

Implementation of the Volcker Rule is another important area where we are working together with other agencies to coordinate our supervisory strategies and our interpretive approaches. An informal, interagency staff-level working group meets regularly to discuss interpretive issues common to all of the agencies with a goal of developing and publishing uniform answers to frequently asked questions. The agencies published the first set of "Frequently Asked Questions" on their respective websites on June 10, 2014. In addition, the agencies are discussing how the collaborative approach to supervision in use among the banking agencies could be expanded to include the SEC and the CFTC for purposes of Volcker compliance supervision. I strongly support a supervisory approach that promotes orderly, coherent supervision by the agencies involved in implementing the Volcker Rule, and I look forward to our ongoing cooperation toward that end.

The interconnectedness of the global financial system has also increased the importance of effective international supervisory coordination and collaboration. As members of the Basel Committee, the OCC and the other U.S. federal banking agencies played a critical role in developing international standards incorporating many lessons learned since the financial crisis, such as those reflected in the agencies' enhanced capital rule. In addition, OCC staff serves on numerous Basel Committee working groups and chairs its Supervision and Implementation Group (SIG). The SIG has overseen the Basel Committee's recent work disseminating good practices on stress testing and business model analysis, as well as updating principles for bank governance, risk data aggregation, and the management of supervisory colleges.

The OCC, along with the FDIC and FRB, also regularly enters into arrangements with foreign regulators that broadly govern information access and sharing. The purpose of these arrangements, which include Memoranda of Understanding, statements of cooperation, and exchanges of letters, is to assist each regulator in obtaining the information necessary to carry out its respective supervisory responsibilities. They address issues including cooperation during the licensing process, the supervision of ongoing activities, and the handling of problem banks.

The OCC also plays an important role in international discussions concerning cross-border resolutions including through the Financial Stability Board's Cross-Border Crisis Management Group and the Legal Experts Group of the Resolutions Steering Group. In addition, the OCC participates in such discussions in firm-specific Crisis Management Groups and Supervisory Colleges and on a bilateral basis with prudential supervisors. For example, we have been working with the FDIC, FRB, SEC, and numerous foreign jurisdictions to develop agreements to facilitate coordination in future crises that affect significant, cross-border financial institutions.

VI. Emerging Issues: Cybersecurity

While it is essential that we learn lessons from history, it is unlikely that the challenges of tomorrow will take the same form as those of the past. The now regular and wide-scale reports of cyberattacks underscore the importance of cybersecurity and preparedness. It is clear that some of these attacks use increasingly sophisticated malware and tactics. With this in mind, I want to share with you what the OCC and our colleagues in the banking regulatory community are doing to address one of the most pressing concerns facing the financial services industry today -- the operational risks posed by cyberattacks. There are few issues more important to me,

to the OCC, and to our country's economic and national security than shoring up the industry's and our own defenses against cyber threats.

In June 2013, the FFIEC, which I currently chair, announced the creation of the Cybersecurity and Critical Infrastructure Working Group (CCIWG). This group coordinates with intelligence, law enforcement, the Department of Homeland Security, and industry officials to provide member agencies with accurate and timely threat information. Within its first year, this working group released joint statements on the risks associated with "distributed denial of service" attacks, automated teller machine "cash-outs," and the wide-scale "Heartbleed" vulnerability. They held an industry webinar for over 5,000 community bankers and conducted a cybersecurity assessment of over 500 community institutions. The information from this assessment will help FFIEC members identify and prioritize actions that can enhance the effectiveness of cybersecurity-related guidance to community financial institutions.

The CCIWG is also working to identify gaps in the regulators' examination procedures and examiner training to further strengthen the banking industry's cybersecurity readiness and its ability to address the evolving and increasing cybersecurity threats. The OCC will continue to work with the institutions we supervise, our federal financial regulatory colleagues, and others within federal, state, and local governments as we address this ongoing threat to our financial system.

Conclusion

Thank you again for the opportunity to appear before you and to update the Committee on the OCC's continued efforts to implement the Dodd-Frank Act and other initiatives at the agency.