For Release Upon Delivery
10:30 a.m., February 14, 2013

TESTIMONY OF

THOMAS J. CURRY
COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

February 14, 2013

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Chairman Johnson, Ranking Member Crapo, and members of the Committee, thank you for the opportunity to report on the Office of the Comptroller of the Currency's (OCC) progress in implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act). Before providing that progress report, however, I would like to begin with a brief review of current conditions in the portions of the banking industry that the OCC supervises.

The OCC supervises more than 1,800 national banks and federal savings associations, constituting approximately 26 percent of all federally-insured banks and savings associations which, together, hold more than 69 percent of all commercial bank and thrift assets. These institutions range in size from over 1,600 community banks with assets of $1 billion or less to the nation's largest and most complex financial institutions with assets exceeding $1 trillion. I am pleased to report that the institutions we supervise have made significant strides since the financial crisis in repairing their balance sheets through stronger capital, improved liquidity, and timely recognition and resolution of problem loans. For national banks and federal savings associations, Tier 1 common equity is at 12.5 percent of risk-weighted assets, up from its low of just over 9 percent in the fall of 2008.[1] The current capital leverage ratio is now about 9 percent, which is up almost a third from its recent low. Reliance on volatile funding sources has dropped from its fall 2006 peak of 46 percent of total liabilities to 24 percent today. Asset quality indicators are improving with charge-off rates declining for all major loan categories. Indeed, for all but residential mortgages, charge-off rates have now dropped below their post-1990 averages. Reflecting these positive trends, the number of problem institutions on the Federal Deposit Insurance Corporation's (FDIC) problem bank list has dropped

[1] Performance and financial data are based on September 30, 2012 Call Report information.

from 888 in March 2011 to 694 in September 2012. Problem national banks and federal savings associations dropped from 192 in March 2011 to 165 in September 2012. There were 146 problem national banks and federal savings associations in January 2013.

While these are encouraging developments, banks and thrifts continue to face significant challenges. Net interest margins are being squeezed for both large and small banks. This problem is especially acute for banks under $1 billion in asset size – a group that represents 90 percent of the institutions we supervise – whose margins are near their 20-year low point. Loan growth, while improved, is still only about one-half its historical average pace. We are monitoring these conditions closely and are stressing that, in this environment, institutions should be especially vigilant about monitoring the risks they are taking on. This is certainly not the time to let up on risk management.

We are also mindful that we cannot let the progress that has been made lessen our sense of urgency in addressing the weaknesses and flaws the crisis revealed in our financial system. The global financial crisis was unprecedented in severity and duration, and the depth of the associated recession was the most severe we have experienced in the U.S. since the Great Depression of the 1930s. These financial and economic developments led to a reconsideration of the ways financial markets and financial firms operate and gave impetus to efforts to reform the financial system and its oversight. The Dodd-Frank Act addresses major gaps and flaws in the regulatory landscape, tackles systemic issues that contributed to, or accentuated and amplified, the effects of the recent financial crisis, and built a stronger financial system. The Act requires the federal regulators to put in place new buffers and safeguards to protect against future financial crises and to revise and rewrite many of the rules governing the most complex areas of finance. Additionally, it consolidates authority that had been spread among multiple agencies, and it provides the federal regulators a number of new tools that should help us avoid problems in the future.

The OCC is committed to fully implementing those provisions where we have sole rule writing authority as expeditiously as possible, and to working cooperatively with our regulatory colleagues on those rules and provisions that require coordinated or joint action. As I testified before this Committee in June, I am keenly aware of the critical role that community banks play in providing consumers and small businesses in communities across the nation with essential financial services and access to credit. As we move forward with Dodd-Frank Act implementation, I have directed my staff to look for ways to minimize potential burden on community institutions, and to organize and explain our rulemaking documents to facilitate community bankers' understanding of how the rules affect their institutions.

In response to the Committee's letter of invitation, my testimony will focus on the OCC's overall implementation of the Dodd-Frank Act by providing an update on key provisions of the Act where the OCC has direct rulemaking or other implementation responsibilities.

OCC/OTS Integration

General

One of the most significant of the OCC's milestones in implementing the Dodd-Frank Act has been the successful integration of former Office of Thrift Supervision (OTS) employees and the supervision of federal savings associations into the OCC. The commitment of all involved resulted in a smooth transition, reflecting a merger of experience with a strong vision for the future. This combination was helped by the close relationship forged over the years through our work on common problems and issues. In this spirit of continuity, the OCC has renewed the charters of two advisory committees that the OTS established. I recently attended the first meeting of the Mutual Savings Associations Advisory Committee, where participants engaged in a robust discussion about the challenges that mutual savings associations confront. At next month's Minority Depository Institutions Advisory Committee meeting, I look forward to a productive exchange about the issues that minority-owned depository institutions are facing.

Integration of Regulations

As we have reported previously to the Committee, the OCC also is engaged in a comprehensive effort to integrate the rules applicable to federal savings associations with those that apply to national banks. Our objectives are, first, to develop a single rulebook applicable to both national banks and federal savings associations (except where statutory differences between the two charter types require otherwise); and, second, for both charter types, to identify and eliminate regulatory requirements that are unnecessarily burdensome.

As I have noted before, while we believe a single set of rules will benefit both national banks and federal savings associations, we recognize that change can create uncertainty. We are aiming to begin proposing these integrated rules over the course of this year. As part of our proposals, we will be seeking comments on ways that we can make our rules easier to implement and reduce burden, and I look forward to receiving comments from interested parties on this important issue.

Completed Rulemakings

Final Rule to Revise OCC Regulations to Remove References to Credit Ratings

On June 13, 2012, the OCC published in the *Federal Register* a final rule to implement section 939A of the Dodd-Frank Act by removing references to credit ratings from the OCC's non-capital regulations, including the OCC's investment securities regulation, which sets forth the types of investment securities that national banks and federal savings associations may purchase, sell, deal in, underwrite, and hold.[2] These revisions became effective on January 1, 2013.

Under prior OCC rules, permissible investment securities generally included Treasury securities, agency securities, municipal bonds, and other securities rated "investment grade" by nationally recognized statistical rating organizations such as Moody's, S&P, or Fitch Ratings. The OCC's final rule revised the definition of "investment grade" to remove the reference to credit ratings and replaced it with a new non-ratings based creditworthiness standard. To determine that a security is "investment grade" under the new standard, a bank must perform due diligence necessary to establish: 1) that the risk of default by the obligor is low; and 2) that full and timely repayment of principal and interest is expected. Generally, securities with good to very strong credit quality will meet this standard.

In comments on the proposed rule, banks and industry groups expressed concern about the amount of due diligence the OCC will require a bank to conduct to determine whether the issuer of a security has an adequate capacity to meet financial commitments under the security. The OCC believes that the due diligence required to meet the new

[2] The federal banking agencies' June 2012 proposed capital rulemakings include provisions to remove references to credit ratings from the agencies' capital regulations.

standard is consistent with our prior due diligence requirements and guidance. Under the prior ratings-based standards, national banks and federal savings associations of all sizes should not have relied solely on credit ratings to evaluate the credit risk of a security, and were advised to supplement any use of credit ratings with additional diligence to independently assess the credit risk of a particular security. Nevertheless, the OCC recognized that some national banks and federal savings associations needed time to make the adjustments necessary to make "investment grade" determinations under the new standard. Therefore, the OCC allowed institutions nearly six months to come into compliance with the final rule.

To aid this adjustment process, the OCC also published guidance to assist banks in interpreting the new standard and to clarify the steps banks can take to demonstrate that they meet their diligence requirements when purchasing investment securities and conducting ongoing reviews of their investment portfolios.

Final Rule on Dodd-Frank Stress Tests

On October 9, 2012, the OCC published a final rule that implements section 165(i)(2) of the Dodd-Frank Act and requires certain companies to conduct annual stress tests pursuant to regulations prescribed by their respective primary financial regulator. Specifically, this rule requires national banks and federal savings associations with total consolidated assets over $10 billion (covered institutions) to conduct an annual stress test as prescribed by the rule.

Consistent with the requirements of section 165(i)(2), the final rule defines "stress test," establishes methods for the conduct of the company-run stress test that must include at least three different scenarios (baseline, adverse, and severely adverse), establishes the form and content of reporting, and compels the covered institutions to publish a summary of the results of the stress tests. Commenters on the proposal expressed concern that developing robust procedures for stress testing might require more time at some banks, particularly those that had not participated in the Supervisory Capital Assessment Program or Comprehensive Capital Analysis and Review program. Therefore, the final rule provided that covered institutions with assets over $50 billion were required to start stress testing under the rule in 2012, while covered institutions with assets from $10 to $50 billion are not required to start stress testing until 2013. The final rules of the Board of Governors of the Federal Reserve System (FRB) and the FDIC adopted similar transition provisions.

The requirements for these company-run stress tests are separate and distinct from the supervisory stress tests required under section 165(i)(1) that are conducted by the FRB. Nevertheless, we believe these efforts are complementary and as a result we are committed to working closely with the FRB and the FDIC in coordinating the timing of, and the scenarios for, these tests.

The company-run stress tests under this rule began with the release of stress scenarios by the OCC and other regulators on November 15, 2012, with scenarios covering baseline, adverse, and severely adverse conditions as required under the rule. The rule required covered institutions with more than $50 billion in assets to report the results of the stress tests to the OCC and the FRB by January 5, 2013. The OCC is in the process of reviewing those results. Covered institutions are required to disclose a summary of the results in March of this year.

Interim Final Rule on Lending Limits

The OCC also recently completed a rulemaking to implement Dodd-Frank Act changes to the lending limit rules. Under the National Bank Act, the total loans and extensions of credit by a national bank to a person outstanding at one time may not exceed 15 percent of the unimpaired capital and unimpaired surplus of the bank if the loan is not fully secured plus an additional 10 percent of unimpaired capital and unimpaired surplus if the loan is fully secured. The Home Owners' Loan Act applies this lending limits rule to savings associations, with some exceptions.

Section 610 of the Dodd-Frank Act amended the definition of "loans and extensions of credit" to include any credit exposure to a person arising from a derivative transaction, or a repurchase agreement, reverse repurchase agreement, securities lending transaction, or securities borrowing transaction (securities financing transaction) between a national bank and that person. This new definition also applies to savings associations. This amendment was effective July 21, 2012.

On June 21, 2012, the OCC issued an interim final rule and request for comments that amended the OCC's lending limits regulation to implement section 610 of the Dodd-Frank Act and to provide guidance on how to measure the fluctuating credit exposure of derivatives and securities financing transactions for purposes of the lending limit. This interim rule also consolidated the OCC's lending limits rules applicable to national banks and savings associations. Specifically, the interim final rule provides national banks and savings associations with three methods for calculating the credit exposure of derivative transactions other than credit derivatives, and two methods for calculating such exposure for securities financing transactions. These methods vary in complexity and permit institutions to adopt compliance alternatives that fit their size and risk management requirements, consistent with safety and soundness and the goals of the statute. Providing these options is intended to reduce regulatory burden, particularly for smaller and mid-size banks and savings associations. To permit institutions the time necessary to conform their operations to the amendments implementing section 610, the OCC has provided a temporary exception from the lending limit rules for extensions of credit arising from derivative transactions or securities financing transactions until July 1, 2013. The OCC expects to publish a final rule that amends and finalizes this interim rule in the near future.

Final Rule on Appraisals for Higher Priced Mortgage Loans

In the years leading up to the financial crisis, several consecutive periods of rapid increases in home prices put increasing pressure on the nation's infrastructure for determining the value of properties in connection with underwriting mortgages. The Dodd-Frank Act reflects congressional concern about appraiser independence, appraisal management companies, and alternative property valuation techniques, and adopts several reform measures on these and related topics. Section 1471 of the Dodd-Frank Act, in particular, focuses on property valuation in connection with so-called "higher priced mortgage loans," (HPMLs) which are consumer mortgages made at interest rates that are typically indicative of subprime credit status of the borrower.

Section 1471 amended the Truth in Lending Act to require the OCC, along with the other federal banking agencies, the Bureau of Consumer Financial Protection (CFPB), and the Federal Housing Finance Agency (FHFA), to issue regulations implementing three main requirements for HPML home valuations. First, a creditor is prohibited from extending an HPML to any consumer without first obtaining a full written appraisal performed by a certified or licensed appraiser who conducts a physical property visit of the interior of the property. Second, the creditor must obtain an additional written appraisal from a different certified or licensed appraiser if the HPML finances the purchase or acquisition of a "flipped" property – that is, a property being bought from a seller at a higher price than the seller paid, within 180 days of the seller's purchase or acquisition. The creditor may not charge the consumer for this additional appraisal. Third, the creditor must also provide the applicant with disclosures at the time of the initial mortgage application about the purpose of the appraisal, and must give the borrower a copy of each appraisal at least three days prior to the transaction closing date.

The agencies issued a joint final rule to implement section 1471 on January 18, 2013. Creditors have one year to come into compliance with the new rule's requirements. Consistent with the statute, the final rule exempts all HPMLs that meet the CFPB's definition of a "qualified mortgage" (QM) under the CFPB's "ability to repay" mortgage rules. The CFPB has indicated that this QM exemption will cover a significant portion of the current mortgage market. The agencies also incorporated exemptions from the second appraisal requirement for a number of different types of transactions, including sales in rural areas, and sales by servicemembers who receive deployment or change of station orders.

The agencies also included two key provisions in the final rule to provide creditors with clear guidance on their obligations under the statute. First, the rule provides a specific set of standards the creditor can apply in determining whether the appraiser has submitted an appraisal report that meets the requirements of the statute for an appraisal prepared in accordance with the Uniform Standards of Appraisal Practice and the banking agencies' appraisal regulations pursuant to Title XI of the Financial Institutions Recovery, Reform, and Enforcement Act of 1989. Creditors applying these standards in connection with their review of each appraisal are afforded a safe harbor under the rule. Second, for HPMLs that are originated to fund the purchase of a dwelling, the rule provides numerous examples of the types of documents a creditor may rely upon in determining whether the seller is "flipping" the property within the meaning of the statute.

Final Rule on Retail Foreign Exchange Transactions

On July 14, 2011, the OCC published in the *Federal Register* its final retail foreign exchange transactions rule (Retail Forex Rule) for national banks and federal branches and agencies of foreign banks. The Retail Forex Rule imposes a variety of consumer protections – including margin requirements, required disclosures, and business conduct standards – on foreign exchange options, futures, and futures-like transactions with retail customers (persons that are not eligible contract participants under the Commodity Exchange Act). To promote regulatory comparability, the OCC worked closely with the Commodity Futures Trading Commission (CFTC), Securities Exchange Commission (SEC), FDIC, and FRB in developing the OCC Retail Forex Rule and modeled the OCC Retail Forex Rule on the CFTC's rule.

After the transfer of regulatory authority from the OTS, the OCC updated its Retail Forex Rule to apply to federal savings associations. This interim final rule with request for comments was published in the *Federal Register* on September 12, 2011. The OCC also proposed last October to update its Retail Forex Rule to incorporate the CFTC's and SEC's recent further definition of "eligible contract participant" and related guidance. The OCC is currently working to finalize that proposal.

Ongoing Dodd-Frank Act Rulemakings

The OCC also is continuing to work closely with other federal financial agencies on a number of important regulations to implement provisions of the Dodd-Frank Act where we have joint rulemaking responsibility. I am committed to completing these rulemakings as quickly as possible while recognizing the need to carefully consider and address the important issues that commenters have raised with the proposals.

<u>Volcker Rule</u>

Section 619 of the Dodd-Frank Act added a new section 13 to the Bank Holding Company Act that contains certain prohibitions and limitations on the ability of a banking entity and a nonbank financial company supervised by the FRB to engage in proprietary trading and to have certain interests in, or relationships with, a hedge fund or private equity fund. The OCC, FDIC, FRB, and the SEC issued proposed rules implementing that section's requirements on October 11, 2011. On January 3, 2012, the period for filing public comments on this proposal was extended for an additional 30 days, until February 13, 2012. On January 11, 2012, the CFTC issued a substantively similar proposed rule implementing section 619 and invited public comment through April 16, 2012. The agencies received more than 18,000 comments regarding the proposed implementing rules and are carefully considering these comments as they work toward development of final rules.

Commenters, including members of Congress, representatives of federal and state agencies, foreign governments, domestic and foreign banking entities and industry trade associations, public interest groups, academics and private citizens, offered a wide range of perspectives on nearly every aspect of the proposed rule. Overall, commenters urged the agencies to simplify the final rule, to reduce compliance burdens for entities that do not engage in significant trading or covered fund activities, and to address unintended consequences of the proposed rule. Some commenters urged the agencies to adopt a final rule that would set forth fairly prescriptive standards and narrowly construed exemptions as they believed this would minimize potential loopholes and the possibility of evasion. Other commenters urged the agencies to adopt a more flexible, principles-based approach in the final rule as they believed this would reduce burden and lessen possible unintended consequences.

For example, an area that has drawn much attention from commenters is the proposed approach for distinguishing permissible market-making-related activities from prohibited proprietary trading. Commenters expressed concern that the proposed rule could have an adverse impact on financial markets, investors, and customers that rely on such markets for liquidity. Other commenters advocated that the market-making exemption should be narrowed. Commenters also highlighted issues with the proposed approach for implementing the prohibition on investing in and having certain relationships with a hedge fund and private equity funds, in particular with the manner in which the proposal defines what is a covered fund. Some commenters thought the proposed definition of covered fund was over-inclusive, while others felt it was under-inclusive. Finally, commenters addressed the international implications of the proposal, both in terms of competitiveness of U.S. banking entities and the extraterritorial impact of the proposal on activities of non-U.S. banking entities conducted solely outside of the United States.

Section 619, by its terms, became effective on July 21, 2012. The FRB, in consultation with the other agencies, issued rules governing the period for conforming with Section 619 and in a statement issued on April 19, 2012, further clarified that covered entities have a period of two years after the statutory effective date, which would be until July 21, 2014, to fully conform their activities to the statutory provisions and any final rules adopted, unless the period is extended by the FRB. The OCC, FDIC, SEC, and the CFTC confirmed that they plan to administer their oversight of banking entities under their respective jurisdiction in accordance with the FRB's statement of April 19.

The OCC, together with the other agencies, continues to work diligently in reviewing the comments submitted during the rulemaking process and toward the development of final rules consistent with the statutory language. To ensure, to the extent possible, that the rules implementing section 619 are comparable and provide for consistent application, the OCC has been regularly consulting with the other agencies and will continue to do so.

Credit Risk Retention Rulemaking

Securitization markets are an important source of credit to U.S. households, businesses, and state and local governments. When properly structured, securitization provides economic benefits that lower the cost of credit. However, when incentives are not properly aligned and there is a lack of discipline in the origination process, securitization can result in harm to investors, consumers, financial institutions, and the financial system. During the financial crisis, securitization displayed significant vulnerabilities, including informational asymmetries and incentive problems among various parties involved in the process. To address these concerns, section 941 of the Dodd-Frank Act requires the OCC, together with the other federal banking agencies, as well as the Department of Housing and Urban Development, FHFA, and the 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 agencies issued a joint proposed rulemaking in the *Federal Register* on April 29, 2011. 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 is designed to recognize that the securitization markets have evolved over time to foster liquidity in a wide diversity of different credit products, using different types of securitization structures and to avoid a "one size fits all" approach that would disrupt private securitization and restrict credit availability.

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 proposed QRM definition seeks to set out a conservative, verifiable set of underwriting standards that would provide clarity and confidence to mortgage originators, securitizers, and investors about the loans that would qualify for the exemption. The standards are also designed to simultaneously foster securitization of non-QRM loans, by leaving room for a liquid and competitive market of soundly-underwritten non-QRM loans sufficient to support robust securitization activity.

The proposal generated significant levels of comment on a number of key issues from loan originators, securitizers, consumers, and policy makers. These comments included the role of risk retention and the QRM exemption in the future of 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. Several commenters also were divided on the current risk retention practices of Fannie Mae and Freddie Mac, with some opposing the difference in treatment from private securitizers and others favoring it in recognition of the market liquidity the GSEs presently provide. We recognize this is a significant policy area and are continuing to review the issue.

The proposed menu of risk retention alternatives also attracted significant comment. While many commenters supported the overall approach, securitizers raised numerous concerns about whether the particular options would accommodate established structures for risk retention in differing types of securitization transactions. These commenters recommended a number of structural modifications to the details of the risk retention alternatives.

The agencies have carefully evaluated this extensive body of comments. In addition, the agencies have reviewed the QM criteria issued by the CFPB in January, to which the QRM criteria are statutorily linked. With the QM criteria completing the picture, the agencies are now in a position to consolidate the analytical work done since the comment period closed and finalize the rule.

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, FDIC, FHFA, and Farm Credit Administration, to impose minimum margin requirements on non-cleared derivatives.

The OCC, together with the FRB, FDIC, FHFA, and Farm Credit Administration, published a proposal in the *Federal Register* on May 11, 2011, 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. To address systemic risk concerns, consistent with the Dodd-Frank Act requirement, the agencies proposed to require swaps entities to collect margin for all uncleared transactions with other swaps 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. The proposed margin requirements would apply to new, non-cleared swaps or security-based swaps entered into after the proposed rule's effective date.

With very limited exception, commenters 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 swaps entities. Commenters also raised a number of other important issues, including the types of collateral eligible to be posted for margin obligations, and concerns that the agencies' proposed margin calculation methodology was not properly calibrated to the level of risk presented by the underlying transactions. They also expressed concerns that U.S. and foreign regulators must coordinate as to the level and effective dates of their respective margin requirements, and anticipated that unilateral U.S. implementation of margin rules would eliminate U.S. banks' ability to continue competing in foreign markets that are behind the U.S. in formulating margin rules for their own dealers.

Given the global nature of major derivatives markets and activities, we agree that international harmonization of margin requirements is critical, and we are participating in efforts by the Basel Committee on Bank Supervision (BCBS) and International Organization of Securities Commissions (IOSCO), to address coordinated implementation of margin requirements across G-20 nations. The BCBS-IOSCO working group issued a consultative document in July of 2012, seeking public feedback on a broad policy framework for margin requirements on uncleared swap transactions that would be applied on a coordinated and non-duplicative basis across international regulatory jurisdictions. We and the other U.S. banking agencies and the CFTC re-opened the comment periods on our margin proposals to give interested persons additional time to analyze those proposals in light of the BCBS-IOSCO consultative framework. The banking agencies' comment period closed on November 26, 2012. Most commenters once again focused on the treatment of commercial end users, urging the agencies to adopt the exemptive approach suggested by the BCBS-IOSCO proposal. The BCBS-IOSCO working group continues its discussions with its parent committees to analyze the questions and alternatives presented in the working group's consultative document, and to formulate a regulatory template to guide the participating jurisdictions to a coordinated regulatory structure on uncleared swap margin issues.

Also notable with regard to swap entities, section 716 of the Dodd-Frank Act prohibits the provision of federal assistance (*i.e.*, use of certain FRB advances and FDIC insurance or guarantees for certain purposes) to swaps entities with respect to any swap, security-based swap or other activity of the swaps entity. On May 10, 2012, the OCC, FRB and FDIC published joint guidance for those entities for which they are each the prudential regulator to clarify that the effective date of section 716, *i.e.*, the date on which the prohibition would take effect, is July 16, 2013. Under section 716, following consultation with the CFTC or the SEC, the federal banking agencies shall permit insured depository institutions that qualify as swap entities subject to the prohibition on federal assistance, a transition period of up to 24 months to either divest the swaps entity or cease the activities that would require registration as a swaps entity. The transition period may be extended for up to one additional year by the federal banking agencies after consultation with the CFTC or SEC. The OCC has received a number of requests from national banks for transition periods under section 716 and we are in the process of reviewing and evaluating these requests pursuant to the statutory requirements.

Incentive-Based Compensation

Pursuant to section 956 of the Dodd-Frank Act, in April 2011, the OCC, FRB, FDIC, OTS, National Credit Union Association (NCUA), SEC, and the FHFA (the agencies) issued a joint proposed rule that would require the reporting of certain incentive-based compensation arrangements by a covered financial institution and prohibit incentive-based compensation arrangements at a covered financial institution that provide excessive compensation or that could expose the institution to inappropriate risks that could lead to a material financial loss.[3]

The material financial loss provisions of the proposed rule would establish general requirements applicable to all covered institutions and additional proposed

[3] A "covered financial institution" is a depository institution or depository institution holding company; a registered broker-dealer; a credit union; an investment adviser; Fannie Mae; Freddie Mac; and "any other financial institution" that the regulators jointly determine, by rule, should be covered by section 956.

requirements applicable to certain larger covered financial institutions. The generally applicable requirements would 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.

The proposed rule included two additional requirements for "larger 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. First, a larger financial institution would be required to defer 50 percent of incentive-based compensation for its executive officers for a period of at least 3 years. Second, the board of directors (or a committee thereof) of a larger financial institution also would be required to identify, and approve the incentive-based compensation arrangements for, individuals (other than executive officers) who have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance. These individuals may include, for example, traders with large position limits relative to the institution's overall risk tolerance and other individuals that have the authority to place at risk a substantial part of the capital of the covered financial institution.

The agencies received thousands of comments on the proposal, many of which concerned the additional requirements for larger financial institutions. The agencies are continuing to work together to prepare a final rule that will address the many issues raised by the commenters.

Conclusion

I appreciate the opportunity to update the Committee on the work the OCC has done to implement the provisions of the Dodd-Frank Act, in particular, the completion of a number of important rulemakings and the significant progress that has been made on ongoing regulatory projects. While much has been accomplished, we will continue to move these ongoing projects toward completion. We look forward to keeping the Committee apprised of our progress.