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STATEMENT OF

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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.

Introduction

Chairman Brown, Ranking Member Toomey, and members of the Committee, I am pleased to testify today before the Senate Committee on Banking, Housing, and Urban Affairs. I will provide an update on the activities underway at the Office of the Comptroller of the Currency (OCC) as we seek to ensure that national banks and federal savings associations operate in a safe, sound, and fair manner.

The OCC charters, supervises, and regulates nearly 1,100 national banks, federal savings associations and foreign branches (collectively, "banks") that range in size from very small community banks to the largest, most globally active banks operating in the United States. The vast majority of the institutions we supervise (over 780) have less than $1 billion in assets, while 54 have greater than $10 billion in assets. Together, OCC-supervised financial institutions hold $15.2 trillion in assets—almost 65 percent of all the assets held in commercial U.S. banks.

As Acting Comptroller, I have a responsibility to address issues facing the OCC and the federal banking system. Our mission is to ensure that national banks and federal savings associations operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. To meet this mission, last year I identified four priorities for the agency: (1) guarding against complacency by banks, (2) reducing inequality in banking, (3) adapting to digitalization, and (4) managing climate-related financial risks.

I am pleased with the progress the OCC has made to advance these priorities and will provide an update on each in my testimony below. I will also discuss our efforts to promote the long-term health and viability of the community banks and minority depository institutions (MDIs) that the agency supervises.

<u>(1) Guarding Against Complacency by Banks</u>

The federal banking system remains healthy, despite challenges from the pandemic, current geopolitical events, and rising interest rates. Bank financial conditions and capital levels have been sound for several years and bank liquidity levels have been strong, supporting increases in loan demand, especially in consumer lending. The uncertain economic outlook, however, highlights the importance of not becoming complacent. Vigilance, especially with regards to risk management, is required. For instance, elevated interest rates are leading to unrealized losses on banks' investment portfolios. Although this development does not impact regulatory capital levels for most banks, it warrants careful monitoring. In addition, while credit risk in aggregate remains modest, we are starting to hear about deteriorating credit performance for certain segments. In this environment, proactive risk management, including stress testing at large banks and preparedness for a slowing economy, can help ensure that banks remain strong and able to meet the credit needs of their customers through a range of scenarios.

The OCC also remains mindful of the risks associated with IT operations and cybersecurity, and we have encouraged banks to stay abreast of new technology and threats. Banks need to make appropriate investments to guard against these risks notwithstanding the temptation to postpone updating legacy IT systems or to defer maintenance of existing technology.

Finally, and as I have said previously, we should update the framework for analyzing mergers under the Bank Merger Act.[1] Bank mergers should serve communities, support financial stability and industry resilience, enhance competition, and enable diversity and dynamism within the banking industry. The OCC considers each merger application on its merits and determines whether the proposed transactions meet the statutory and regulatory criteria. At the same time, we need to ensure that these criteria are applied in a manner that does not lead to the formation of a new class of too-big-to-fail banks.

I was pleased to support the recent Advance Notice of Proposed Rulemaking (ANPR) issued by the Federal Deposit Insurance Corporation (FDIC) and the Board of Governors of the Federal Reserve System (FRB) on resolution-related resource requirements for large banking organizations. The joint ANPR represents a concrete step in addressing large banks' financial stability and competition issues. Reevaluating the resolvability risks and requirements for these firms will help to mitigate the risks they may pose to the financial system and the communities they serve.

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[1] See: Acting Comptroller of the Currency Michael J. Hsu Remarks at Brookings on Bank Mergers and Industry Resiliency, May 9, 2022 (occ.gov)

The OCC is also working closely with our federal banking agency peers and the Department of Justice (DOJ) to review bank merger frameworks consistent with the President's Executive Order on promoting competition. The OCC recently announced a public symposium on bank mergers to take place next February that will invite discussion among thought leaders, academics, community groups, and the banking industry on factors such as competition, financial stability, and community impact.

Banks that remain vigilant and guard against complacency in these and other areas will promote a safe, sound, and fair banking system that continues to support the individuals, communities, and businesses they serve.

(2) Reducing Inequality in Banking

Persistent economic inequality can erode trust in the banking system. Americans who lack access to traditional financial products and services or feel exploited by banks may conclude that the system is working against them, rather than for them. The OCC is focused on several initiatives to address this problem.

The OCC, FRB, and FDIC are working together to modernize and strengthen the Community Reinvestment Act (CRA). The recent interagency notice of proposed rulemaking builds on the history of the CRA as critical to motivating bank lending and investment to help meet the credit needs of low- and moderate-income individuals, families, and communities. The proposal also aims to adjust to changes in the banking industry, including internet and mobile banking. The agencies received hundreds of detailed and thoughtful comments on the NPR, including from Members of this Committee, and we are working together to quickly and thoughtfully consider the suggestions.

The OCC continues to support the removal of structural barriers to financial inclusion through Project REACh, or the Roundtable for Economic Access and Change. Through Project REACh, the OCC convenes leaders from banking, business, technology, and civil rights organizations to reduce specific barriers that prevent full, equal, and fair participation in the nation's economy by all consumers. Project REACh's work is divided into four national workstreams addressing (1) affordable homeownership, (2) inclusion for credit invisibles, (3) revitalization of minority depository institutions, and (4) access to capital for small and minority-owned businesses. Significant progress has been made and in July we celebrated the program's second anniversary with a national symposium and discussions that provided progress reports regarding each workstream. Recognizing the local nature of barriers to inclusion, several REACh initiatives have been launched to focus efforts on individual communities, including Los Angeles, Dallas, Washington, D.C., Detroit, and Milwaukee.

The OCC also is pleased to be a member of the Property Appraisal and Valuation Equity (PAVE) task force sponsored by the Department of Housing and Urban Development (HUD) to address discrimination in appraisals. The OCC supports the actions recommended by the Task Force to ensure greater federal oversight and effective monitoring for discrimination in residential property appraisals and technology-based valuation. We are enhancing our supervisory methods for identifying discrimination in appraisals, taking steps to ensure that consumers know of their rights regarding appraisals, and supporting research that may lead to new ways to address the undervaluation of housing in communities of color caused by decades of discrimination.

This year, the OCC began efforts to focus on measuring and improving the financial health of consumers. This outcomes-based approach should help in the evaluation of consumer banking products and services, and in addressing inequality and barriers to financial inclusion. In April, the OCC launched a video series entitled "Financial Health: Vital Signs," which includes interviews and panel discussions with leading voices to raise awareness of opportunities for the industry and other stakeholders to take action to increase support for consumer financial health.

In addressing inequality, it is important to recognize that it is expensive to be poor. Overdrafts can be part of that expense. I have been encouraging banks to improve their overdraft programs with their customers' financial health in mind.[2] As noted in a June 21, 2022, PEW Research article, the largest U.S. banks have made changes to their overdraft policies that could save consumers more than $4 billion annually.[3] The savings are coming from banks lowering penalty fees for overdrafts, reducing the daily maximum number of overdraft fees that are charged, adding a grace period or buffer amount before fees kick in, or eliminating nonsufficient funds fees

[2] See: Don't be the last banker to update your overdraft program | American Banker, March 28, 2022

[3] See: Large Banks Improve Overdraft Policies and Cut Fees | The Pew Charitable Trusts (pewtrusts.org)

or overdraft transfer fees. Changes at the largest national banks could save consumers billions of dollars annually.[4] The OCC has observed significant decreases in overdraft fee revenue in 2022 at the large banks we supervise which should have outsized benefits for Black and Hispanic customers who, as the June PEW article notes, are more likely to incur overdrafts. I am optimistic that the positive changes made by these large banks are inspiring more banks to make similar pro-consumer changes to their overdraft programs. For instance, community banks with outsized revenue from overdrafts have also begun to reform their overdraft programs in ways that are pro-consumer and reduce each bank's reliance on such fees.

Additionally, the OCC continues to strengthen its supervision processes and enhance its resources devoted to compliance with fair lending laws. For example, the OCC updated its annual process for screening bank retail lending activities to provide a more targeted fair lending examination strategy and to better deploy resources to identify weaknesses or wrongdoing. If the OCC's fair lending examinations find evidence of a potential pattern or practice of discrimination, the OCC makes referrals to the DOJ and/or HUD, as required by law. In October 2021, the OCC reaffirmed its obligation to refer potential fair lending violations to the DOJ and share our extensive examiner, economist, and legal findings to ensure a unified and unmitigated focus on the supervision and enforcement of fair lending laws.[5] It is not acceptable that redlining and other forms of lending discrimination continue in the year 2022, and the OCC will not hesitate to take enforcement action if necessary.

Within the banking industry specifically, there is opportunity to improve upon diversity and inclusion at every level—from the board rooms to leadership teams to employees. Diversity of background and thought will make these institutions stronger, fairer, and more representative of their communities. Data would help banks, regulators, and the public recognize improvements and benefits. Currently, banks may voluntarily report diversity data to the federal banking regulators although less than 20 percent of banks choose to do so. Increasing participation in this reporting would provide greater visibility into the diversity of the banking industry and identify where banks

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[4] America's Largest Banks Make Major Overdraft Changes That Will Help Consumers | The Pew Charitable Trusts (pewtrusts.org)

[5] Remarks by Acting Comptroller Michael J. Hsu at the Department of Justice, Combatting Redlining Initiative Announcement (occ.gov), Oct. 22, 2021.

can make better progress.

The OCC is also doing its part to improve our own diversity and inclusion. Over the past 10 years, the OCC's total minority workforce has become more reflective of the country as a whole, and manager and senior-level manager positions held by minorities and women also have increased.[6] While this trend is positive it is clear that more needs to be done.

Additionally, the OCC has nine employee network groups,[7] administered by our Office of Minority and Women Inclusion, to support diversity and inclusion throughout the agency by sponsoring programs to help attract, develop, and retain the best talent regardless of race, national origin, gender, physical abilities, or age. These groups help to attract and retain employees from diverse backgrounds and to create an inclusive work environment that promotes a sense of belonging. In addition, in furtherance of our support of military members and their families, the agency is now a partner with the Department of Defense Military Spouse Employment Partnership (MSEP) which is an initiative around targeted recruitment and employment.

For the fourth consecutive summer, the OCC hosted its High School Scholars Internship Program (HSSIP), a six-week paid internship for minority students from public and charter high schools in the District of Columbia. This program provides an opportunity for students to explore a variety of career paths at the OCC, gain an understanding of the financial services industry, and engage in enrichment activities on financial literacy and leadership fundamentals. Since its inception, the program has expanded beyond the OCC and now includes interns at the Federal Housing Finance Agency, the Securities and Exchange Commission, and the National Credit Union Administration. In addition to our HSSIP program, the OCC has provided minority college students with paid internship opportunities for more than a decade through its National Diversity

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[6] The OCC's minority population has increased from 30 to 36 percent. Manager positions held by minority and female populations increased from 21 to 28 percent and 37 to 39 percent respectively. Senior level manager positions held by minority and female employees increased from 20 to 25 percent and 27 to 30 percent respectively. The Executive Committee of the agency is now 50% female and 50% non-white.

[7] These employee network groups are the Coalition of African-American Regulatory Employees (CARE); Generational Crossroads; HOLA; Network of Asian Pacific Americans (NAPA); Native American Tribes & Indigenous Voices (NATIVe) PRIDE; The Women's Network (TWN); Veterans Employee Network (VEN); and the Differently Abled Workforce Network (DAWN).

Internship Program.

(3) Adapting to Digitalization.

Like many industries, the business of banking is becoming increasingly digitalized. This is occurring as technology firms expand into financial services and, to a lesser degree, via developments with cryptocurrencies. While cryptocurrency matters have received the most visibility over the past year, especially recently, I believe that financial technology generally, and fintech and big technology companies specifically, will warrant much more of our attention going forward.

Increasingly, retail banking is being conducted online and through mobile phones. Similar to other industries, financial services that were integrated and contained within the banking industry are being compartmentalized and offered by a greater number of entities, including technology firms. Digitalization has put a premium on online and mobile engagement, customer acquisition, customization, big data, fraud detection, artificial intelligence, machine learning, and cloud management. As a result, bank-fintech partnerships have grown exponentially and become more complicated, driving changes to banks' risk profiles.

The OCC has adjusted its bank information technology (BIT) examinations in response to these technological innovations. Today, these examinations include assessments of ransomware, artificial intelligence, cloud computing, and distributed ledger technology. In addition, the OCC is focused on ensuring banks have an effective risk management framework in place for fintech partnerships generally and, more specifically, digitalization. Currently, a majority of our supervisory concerns relate to fundamental elements of risk management, e.g., board oversight, governance, and internal controls. Common issues involve insufficient information security controls, change management issues, particularly with emerging products and services, and IT operational resilience.

Our recently released five-year Strategic Plan[8] also acknowledges the increase in digitalization and the need to be agile and credible in addressing them. We are building on the

[8] See: OCC Releases Strategic Plan for Fiscal Years 2023-2027 | OCC

excellent work of staff over the last five years in the fintech/crypto space with regards to policy and service providers and related to IT and operational resilience supervision. We are also working closely with our interagency peers and engaged in ongoing dialogue to help ensure that we have a shared understanding of how the financial system is evolving and to minimize opportunities for regulatory arbitrage and races to the bottom.

Much more work remains. My sense is that we are still in the early stages of a significant shift in how banking services will be provided in the future. Last month, I announced the creation of the Office of Financial Technology, which will be established in 2023. This new office will help ensure the OCC continues to be a leader in developing expertise in financial technology and the financial technology landscape. It will expand upon the significant work and considerable successes of the OCC's Office of Innovation, which was established in 2016 to coordinate the agency's efforts around responsible innovation. By expanding our aperture, engaging more substantively with nonbank technology firms, and mapping out bank-fintech relationships and risks, we can help ensure that banking remains trusted and safe, sound, and fair as the system evolves.

In addition, the OCC has adopted a "careful and cautious" approach to crypto in the federal banking system. This is reflected in Interpretive Letter 1179,[9] which establishes guardrails to clarify that the institutions we supervise should not engage in certain crypto activities unless they demonstrate that the activities can be performed in a safe, sound, and fair manner. This approach has proven to be prudent following the Terra stablecoin collapse in May and more recently with the bankruptcy of FTX. Despite contagion across cryptocurrencies and several crypto platforms, the federally regulated banking system has, for the most part, been largely unaffected.

(4) Managing Climate-Related Risk to the Federal Banking System

The OCC's focus on climate-related financial risk is firmly rooted in our mandate to ensure that national banks operate in a safe and sound manner. It is not our role to tell bankers what customers or legal businesses they may or may not have as customers. We do not pick winners or losers. Rather, we are committed to staying in our safety and soundness lane, which means

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[9] See: Interpretive Letter 1179 (occ.gov)

focusing on banks' risk management of climate-related financial risks, not on setting industrial policy.

Climate-related financial risks pose novel challenges to traditional risk management. We have taken several steps to build our expertise and capacity to meet those challenges. Shortly after my appointment, the OCC joined the Network for the Greening of the Financial System and established a Climate Risk Officer position at the agency to focus on these issues.

In December, we issued for comment Principles for Climate-Related Financial Risk Management for Large Banks. The draft principles focus on the climate-related risk management capabilities of large banks, i.e., those with at least $100 billion in consolidated assets. Our focus on large banks is intentional, as that is where the risks are most complex and material. We are continuing to consider the comments and working with our interagency colleagues to determine the next steps in this area.

Community banks have expressed concern about the scope of our climate risk-related efforts. I have made a concerted effort to meet with community bankers and have traveled across the country to listen to them and hear from them directly about their communities and experiences handling acute weather events. I believe that earning their trust on this issue is vitally important. As such, I am committed to continued dialogue and constructive engagement with all stakeholders, including community bankers, as we build our climate risk management expertise.

5. The OCC Supports Community Banks and MDIs

Overseeing the safety and soundness of community banks is central to the mission of the OCC. The OCC is committed to fostering an environment that allows well-managed community banks to grow and thrive. In particular, we are taking specific actions to support community banks in five areas: (1) revitalizing minority depository institutions (MDIs), (2) reducing bank assessments, (3) promoting de novos, and (4) tailoring regulation based on size and complexity.

Revitalizing of Minority Depository Institutions – MDIs are on the front lines of serving low-income, minority, rural, and other underserved communities and are a critical source of credit for them. However, MDIs have fallen in number and, until recently, faced challenges with accessing capital, adopting new technology, and modernizing their infrastructures. In July, the OCC issued an updated policy statement on MDIs[10] that reaffirms the agency's commitment to these institutions and describes the range of programs in place to support MDIs. The policy statement serves to focus the agency's efforts to ensure MDIs remain a bedrock of financial access and inclusion.

The OCC's Project REACh has helped to expand relationships between larger banks and MDIs through capital investments dedicated to improving the technological infrastructure of MDIs. Since 2020, 26 banks signed Project REACh's pledge to support MDIs[11] to provide dedicated technical assistance for MDI staff talent development, diversification of product offerings, and nearly $500 million in investments to MDIs.

Reducing Bank Assessments – Effective March 2023, the OCC will make a 40 percent reduction in assessments for a bank's first $200 million in assets and a 20 percent reduction for bank assets between $200 million and $20 billion. This recalibration will result in a $41.3 million reduction in assessments for community banks. We are hopeful that this reduction will provide community banks with extra capacity to invest and seize opportunities related to digitalization, compliance, cybersecurity, and personnel.

Promoting De Novo - A healthy community bank industry needs a pipeline of new entrants and start-ups. The OCC was pleased to charter a de novo community bank minority depository institution in Houston, Texas, in May of this year. This was the first de novo MDI that the OCC has chartered since before the financial crisis and a welcome addition to the Houston communities it will serve. The OCC is also actively engaged with our Mutual Savings Association Advisory Committee to understand the impediments to the chartering and formation of de novo mutual savings associations.

Regulation Based on Size and Complexity —It is imperative that regulatory expectations for banks are differentiated based on their size and complexity. We are mindful of concerns from community bankers that requirements for large banks should not trickle down to smaller banks as

[10] See: OCC Updates Policy Statement on Minority Depository Institutions | OCC

[11] See: Project REACh Pledge Released to Promote Vitality of Minority Depository Institutions | OCC

such requirements can be excessive and tie up scarce personnel and other resources. The OCC will remain diligent in guarding against such outcomes. Direct engagement with each community bank that we supervise, and our two Federal Advisory Committees: The Minority Depository Institution Advisory Committee and the Mutual Savings Association Advisory Committee will continue to assist in this effort.

Conclusion

I am committed to ensuring that OCC-supervised banks operate in a safe, sound, and fair manner, meet the credit needs of their communities, treat all customers fairly, and comply with laws and regulations. As we work to ensure that the federal banking system remains a source of strength to the U.S. economy, we will continue to advance key agency priorities to ensure the federal banking system is well positioned to respond to community and consumer needs well into the future.