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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

I am pleased to testify before the Committee on Banking, Housing, and Urban Affairs to provide information about the Office of the Comptroller of the Currency's (OCC) actions and responses to recent market stress, and to update Members of the Committee on efforts underway as we work 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"). These institutions 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 have less than $1 billion in assets, while 56 have greater than $10 billion in assets. Together, OCC-supervised financial institutions hold more than $15 trillion in assets—almost 65 percent of all the assets held in commercial U.S. banks.

The federal banking regulators have worked closely together since March to maintain financial stability and confidence in the banking system in response to the recent market stress. Adequate levels of capital going into the recent turmoil have helped to limit the risk of contagion. Despite the market stress, the federal banking system has remained resilient and national banks and federal savings associations have remained well positioned to serve their customers.

The OCC is closely monitoring the conditions of the institutions we supervise and working with them to ensure that their liquidity and capital positions remain sound and that they are "on the balls of their feet" with regard to risk management. The vast majority of OCC-supervised banks have not experienced stress with regard to their depositors or business customers. After the failures of Silicon Valley Bank and Signature Bank, we carefully reviewed the condition of the federal banking system, including banks with significant levels of uninsured deposits to ensure that their cash holdings and borrowing capacity can easily meet potential depositor withdrawals. In addition, many have taken steps to reduce risk in light of market conditions.

Over the past two years, I have consistently emphasized to bankers the importance of guarding against complacency and having strong risk management policies and practices in place. Most OCC regulated banks have heeded this message and been able to successfully navigate the rise in interest rates and changing economic outlook. OCC examiners will continue to actively monitor market conditions and engage with banks to help ensure they are prepared to meet future challenges.

My written statement begins with observations about recent events, then provides an overview of our work to advance four critical agency priorities that I initiated after becoming Acting Comptroller two years ago.

Observations on the Recent Bank Failures

The recent bank failures have prompted several reviews of the strengths and weaknesses of bank regulatory frameworks and supervisory programs.[1] While none of the failed banks were regulated by the OCC, we are using those reviews to do a "look across" and evaluate our own supervisory processes to identify any areas that may need adjustment.

Based on my perspective as Acting Comptroller and twenty years of experience as a financial regulator, I would like to offer some preliminary observations on steps that can be taken to restore full confidence in the banking system.

Supervisors need support to act in a timely and effective manner. The reviews by the state and primary federal regulators of Silicon Valley Bank (SVB) and Signature Bank shared a consistent theme. Awareness and identification of weaknesses were not the problem; rather, timely and forceful supervisory action were lacking.

Supervisors at the OCC and the other banking agencies play a critical role in keeping the banking system safe and sound by exercising discretion. The degree to which supervisors feel empowered to exercise that discretion impacts their will to act in a timely and forceful manner. Clear support to empower supervisors to exercise discretion and act when needed will help keep

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[1] U.S. Government Accountability Office, "Bank Regulation: Preliminary Review of Agency Actions Related to March 2023 Bank Failures," (April 28, 2023); Board of Governors of the Federal Reserve System, "Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank," (April 28, 2023); California Department of Financial Protection and Innovation, "Review of DFPI's Oversight and Regulation of Silicon Valley Bank," (May 8, 2023); Federal Deposit Insurance Corporation, "FDIC's Supervision of Signature Bank," (April 28, 2023); New York State Department of Financial Services, "Internal Review of the Supervision and Closure of Signature Bank," (April 28, 2023).

the banking system safe and sound.

One challenge with the exercise of supervisory discretion is ensuring consistency, particularly across regulatory bodies. To minimize the effects of "charter shopping" by banks, federal and state banking agencies should commit to leveling up supervision and ensuring uniform and consistent standards across agencies. One of my priorities as Chair of the Federal Financial Institutions Examination Council will be getting back to basics, focusing on the Council's mission to promote uniform principles and standards in the supervision of financial institutions.

Regulations regarding the resilience and resolvability of large banks need to be strengthened. The failures of SVB and Signature Bank required the invocation of the systemic risk exception in order to avoid contagion and financial instability. Stronger resiliency requirements for large banks with regard to capital and liquidity would have reduced the probability of their failures. Stronger resolvability requirements – such as bail-in-able long-term debt to absorb losses and separability to enable rapid sales to third parties – would have facilitated orderly failures with less government involvement.[2] The OCC is working closely with the Federal Reserve and FDIC to address these issues.

Deposit insurance coverage should be updated. The recent bank turmoil has been driven in part by uncertainty about the safety of uninsured deposits. The FDIC's recent report on deposit insurance presents several options for Congressional consideration.[3] The report's analysis is worth careful consideration, especially its conclusion that expanding FDIC insurance in a targeted manner to cover business payment accounts may have the greatest potential to meet the objectives of deposit insurance and financial stability while constraining moral hazard.

An updated and properly calibrated FDIC deposit insurance system would be the most effective and efficient way to address the liquidity risk of uninsured deposits. In the meantime, we have been working with our banks, especially those with significant levels of uninsured deposits, to ensure that their cash holdings and borrowing capacity can meet depositor withdrawals. We remain committed to supervising banks so that depositors can rest assured that their money is safe.

[2] Remarks of Acting Comptroller Michael J. Hsu before the Wharton Financial Regulation Conference 2022, "Financial Stability and Large Bank Resolvability," (April 1, 2022).
[3] FDIC, "Options for Deposit Insurance Reform" (May 1, 2023).

The diversity of the banking system must be preserved as the industry evolves. The recent turmoil has increased the market's scrutiny of regional and midsize bank business models, outlooks, and valuations. The OCC has been working on updating the analytical frameworks related to the bank merger guidelines that the federal banking agencies and Department of Justice must follow when considering bank mergers.[4] The recent turmoil has increased the urgency of these efforts. It also presents an opportunity to shape a more competitive, more community-oriented, and more resilient banking system. The OCC is committed to being open-minded when considering merger proposals and to acting in a timely manner on applications, consistent with the requirements of the Bank Merger Act.

As the industry evolves, I believe strongly that it is paramount that we preserve the diversity of the banking system, including the community banking model. Community banks—as well as regional and midsize banks—play an invaluable role in supporting the extraordinarily diverse range of economies, small businesses, and individuals across the country. I have spoken to many community, regional and midsize bankers about this and will continue to engage with them on this important priority.

Guarding Against Complacency by Banks

Two years ago, when I became Acting Comptroller, I prioritized and highlighted the need to guard against complacency.[5] Since then, I have emphasized the importance of both paying attention to tail risks and being disciplined with regards to "blocking and tackling," e.g., interest rate and credit risk management.[6]

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[4] The OCC hosted a symposium on bank mergers on February 10, 2023. Video of the symposium is available through the OCC's Digital Media Library.

[5] Statement of Michael J. Hsu, Acting Comptroller of the Currency, before the Committee on Banking Housing, and Urban Affairs, United States Senate (Aug. 3, 2021); Statement of Michael J. Hsu, Acting Comptroller of the Currency, before the Committee on Financial Services, United States House of Representatives (May 19, 2021)

[6] Remarks of Acting Comptroller of the Currency Michael J. Hsu at the RMA Risk Management Virtual Conference, "Promoting Prudent Credit Risk Management and Diversity and Inclusion," (December 5, 2022); Remarks by Acting Comptroller of the Currency Michael J. Hsu before the American Bankers Association on Tail Risks (March 31, 2022).

Continued industry and regulatory vigilance is critical.[7] Elevated interest rates put pressure on banks' cost of funding. Asset-liability management practices, including liquidity and interest rate risk modeling, stress testing, and sensitivity analysis, are critical risk management practices for banks. The commercial real estate market, in particular office space, is expected to experience credit strains due to higher vacancy rates and higher interest rates as loans refinance. We also expect delinquency and loss rates in the retail and mortgage space to increase from their historically low levels. Banks will need to anticipate and manage these trends and have contingency plans to mitigate adverse impacts.

To effectively guard against complacency, we must also be attentive to risks beyond the daily headlines. The OCC remains focused on risks associated with IT operations and cybersecurity, and we have encouraged banks to stay abreast of new technologies and threats. Banks need to invest appropriately to guard against these risks notwithstanding the temptation to postpone updating legacy IT systems or to defer maintenance of existing technology.[8]

In an environment of uncertainty, bank capital remains foundational. As we have seen, strong capital requirements have proven repeatedly to be a critical element of the bank regulatory framework and help to ensure that the banking industry serves as a source of strength during times of economic stress. The OCC remains committed to implementing the enhanced regulatory capital requirements that align with the final set of Basel III standards, and it is important that we move forward as soon as possible. The implementation of these standards for large banking organizations will strengthen the resilience of the domestic banking system.[9]

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.

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[7] Remarks of Acting Comptroller of the Currency Michael J. Hsu at the Bloomberg Risk & Regulation Week 2022, "When the Tide Goes Out," (May 17, 2022).

[8] Remarks of Acting Comptroller of the Currency Michael J. Hsu before the Joint Meeting of the Financial and Banking Information Infrastructure Committee and the Financial Services Sector Coordinating Council (Aug. 2, 2022).

[9] Remarks of Acting Comptroller of the Currency Michael J. Hsu at the IIB Annual Washington Conference, "Trust and Global Banking: Lessons for Crypto," (March 6, 2023).

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 including efforts through Project REACh – the OCC's Roundtable for Economic Access and Change – and through membership in the Property Appraisal and Valuation Equity (PAVE) task force sponsored by the Department of Housing and Urban Development. This year, the OCC also undertook efforts to focus on measuring and improving the financial health of consumers, and recently produced its second discussion in the Financial Health: Vital Signs video series focused on the importance of building assets.

The OCC has been working with the Federal Reserve and FDIC to modernize and strengthen the Community Reinvestment Act (CRA). The CRA is a critical tool for bank regulators to expand financial inclusion and opportunity for all Americans, especially the underserved. The agencies received hundreds of detailed and thoughtful comments on the Notice of Proposed Rulemaking, including from Members of this Committee, and we are working together to consider the suggestions.

In addressing inequality, I am mindful that it is expensive to live paycheck to paycheck and overdrafts can be part of that expense. While bank overdraft programs can be helpful for consumers facing short-term liquidity issues, they also present a variety of risks to consumers and to banks, including compliance, operational, reputation and credit risks. Last month, the OCC published a bulletin to provide guidance to bankers to address the risks associated with bank overdraft protection programs, identify certain practices that may result in heightened risk exposures, and describe practices that may assist banks with managing these risks.[10] The guidance also encourages banks to explore offering low-cost accounts, or other lower cost alternatives for covering overdrafts, such as overdraft lines of credit or linked accounts to consumers. The guidance furthers the agency's support for solutions that help banks meet the evolving needs of

[10] OCC Bulletin 2023-12, "Overdraft Protection Programs: Risk Management Practices" (Apr. 26, 2023).

their consumers, businesses, and communities.[11]

Adapting to Digitalization

The business of banking is becoming increasingly digitalized. Technology firms are expanding into financial services, and bank partnerships with fintechs are now commonplace. I believe that financial technology generally, and fintech and big technology companies specifically, will warrant even more attention in the future.

On March 30, 2023, the OCC announced the establishment of an Office of Financial Technology to enhance the agency's expertise and ability to adapt to the rapid pace of technological changes in the banking industry.[12] The Office of Financial Technology broadens the OCC's focus in this area and contributes to the agency's leadership and agility in adapting to the evolution of banking services. It expands 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. The office is responsible for the analysis, evaluation and discussion of relevant trends in financial technology, emerging and potential risks, and enhancing our expertise on matters relating to digital assets, fintech partnerships, and changing technologies and business models.

We are also working closely with our interagency peers to ensure that banks appropriately manage their risks associated with third-party relationships, including relationships with financial technology companies. Banks need to be mindful that partnering with third parties does not diminish their responsibility to ensure the activity is performed in a safe and sound manner and in compliance with applicable laws. In addition, as open banking gains attention in the United States, bank regulators must prepare and engage with stakeholders to ensure that the safety, soundness, and fairness of banks' operations are maintained as consumer rights with regards to their financial data are strengthened.

Managing Climate-Related Financial Risks to the Federal Banking System

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[11] Remarks of Acting Comptroller of the Currency Michael J. Hsu at the NCRC's 2023 Just Economy Conference, "Elevating Fairness," (Mar. 30, 2023).

[12] OCC News Release 2023-31, "OCC Establishes Office of Financial Technology" (Mar. 30, 2023).

The OCC's focus on climate-related financial risk is firmly rooted in our mandate to ensure that national banks and federal savings associations operate in a safe and sound manner. It is not our role to tell bankers who they can and cannot serve. We do not pick winners or losers, but focus on ensuring that banks understand the climate related financial risks they face and have robust risk management programs in place to control and monitor those risks.

The OCC continues to consider the comments received on its proposed Principles for Climate-Related Financial Risk Management for Large Banks issued in December 2021 and is working with the other banking agencies to determine next steps. Our focus is on large banks with at least $100 billion in consolidated assets because that is where the risks are most complex and material. In our work to date, we have found that most large banks have established board governance and senior management structures to address climate-related financial risks, and continue to develop processes to measure and monitor the potential exposures to those risks.

The OCC Supports Community Banks and MDIs

The safety and soundness of community banks is central to the OCC's mission, and the agency is committed to fostering an environment that allows well-managed community banks to grow and thrive.

Revitalizing of Minority Depository Institutions (MDI). 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, the number of MDIs has decreased, and they have historically faced challenges with accessing capital, adopting new technology, and modernizing their infrastructures. In July 2022, the OCC issued an updated policy statement on MDIs that reaffirms the agency's commitment to these institutions and describes the range of programs in place to support MDIs.[13] The policy statement serves to focus the agency's efforts to ensure MDIs remain a bedrock of financial access and inclusion.

Regulation Based on Size and Complexity. It is imperative that regulatory expectations for banks are differentiated based on several factors, including banks' size and complexity. We are mindful of concerns from community bankers that requirements for large banks should not trickle

[13] Refer to OCC News Release 2022-92,"OCC Updates Policy Statement on Minority Depository Institutions" (Jul. 27, 2022).

down to smaller banks, as such requirements can pose an undue burden and unnecessarily tie up scarce personnel and other resources. The OCC will remain diligent in guarding against such outcomes, while ensuring the federal banking system remains safe, sound, and fair. We plan to continue to engage directly 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

Throughout the recent financial stress, the OCC has closely monitored the conditions of the national banks and federal savings associations we regulate. We have reviewed the recent reports issued by our peer regulators. We are continually evaluating our approach to supervision to ensure it remains effective and properly calibrated.

At the same time, the OCC has made progress advancing several priority areas. The federal banking system remains a source of strength to the U.S. economy and the institutions we regulate remain prepared to serve their customers, businesses, and communities in a safe, sound, and fair manner.