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TESTIMONY OF

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Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HOUSE COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

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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.

I. Introduction

Chairman Neugebauer, Ranking Member Clay, and members of the Subcommittee, thank you for the opportunity to appear before you today. In response to the Subcommittee's invitation letter, my testimony focuses on the challenges facing small national banks and federal savings associations (hereafter referred to as community banks) and the work of the Office of the Comptroller of the Currency (OCC) to help these institutions remain a vibrant part of our nation's financial system. I also discuss specific steps we are taking to address regulatory burden on community banks, OCC recommendations for legislative action in furtherance of this goal, and our progress on the review required pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA).

Before describing these initiatives, I would like to share the OCC's perspective on community banks. The OCC supervises approximately 1,400 institutions with assets under \$1 billion. These community banks provide many of the essential financial services and much of the credit necessary for our nation's economic growth. Throughout the country, these banks help small businesses thrive by offering personalized service and credit products tailored to their customers' needs. In addition, these banks and their employees strengthen our cities and towns by helping to meet municipal finance needs and actively participating in civic life.

Overseeing the safety and soundness of community banks is central to the mission of the OCC. Approximately two-thirds of our examination staff is dedicated to the supervision of these institutions. In my role as Senior Deputy Comptroller for Midsize and Community Banks, I regularly meet with community bankers to hear first-hand about their successes, their challenges, and their frustrations. I have seen how well-managed

community banks weathered the financial crisis and provided a steady source of credit to their communities. But I have also heard their concerns about the long-term viability of their business models. In addition, I have heard about their frustration with the time and resources they spend trying to track and comply with regulatory requirements — time and resources they believe could be better spent responding to the needs of their customers and communities.

We take these concerns seriously and are taking steps to help community bankers meet these challenges and navigate the changing regulatory landscape by ensuring that the OCC's supervisory policies and regulations are appropriately tailored to community banks.

II. The OCC's Approach to Community Bank Supervision

The OCC is committed to fostering a regulatory climate that allows well-managed community banks to grow and thrive. We have built our supervision of community banks around local field offices where the local Assistant Deputy Comptroller (ADC) has responsibility for the supervision of a portfolio of community banks. Each ADC reports up to a District Deputy Comptroller who, in turn, reports to me. Our community bank examiners are located in over 60 communities throughout the United States, close to the banks they supervise.

Through this supervisory structure, community banks receive the benefits of highly trained bank examiners with local knowledge and experience, supplemented by the resources and specialized expertise that a nationwide organization can provide. Our bank supervision policies and procedures establish a common framework and set of expectations. Portfolio managers tailor the supervision of each community bank to its individual risk profile, business model, and management strategies. We give our ADCs considerable decision-making authority,

reflecting their experience, expertise, and first-hand knowledge of the institutions they supervise, and we expect them to make most supervisory decisions locally.

We also seek to ensure that we apply our supervisory policies, procedures, and expectations in a consistent and balanced manner. For example, a key element of the OCC's supervisory philosophy is open and frequent communication with the banks we supervise. In this regard, my management team and I encourage bankers with concerns about examination findings to raise these concerns with their examiners and with the district management team that oversees the bank. Our ADCs and District Deputy Comptrollers expect and encourage such inquiries.

If a banker does not want to pursue these avenues of communication, our Ombudsman provides a venue for bankers to discuss their concerns, either informally or formally. The OCC's Ombudsman is fully independent of the supervisory process, and he reports directly to the Comptroller. This office provides bankers with an impartial ear to hear complaints and a mechanism to facilitate the resolution of disputes with our examination staff, in addition to hearing formal appeals of supervisory determinations.

The OCC's multi-layered, informal and formal process for addressing concerns about examination findings encourages the resolution of disagreements at various stages of the examination cycle and with various management levels within the OCC. Furthermore, as a safeguard, the Ombudsman contacts a bank or savings association 60 days after resolution of an appeal and again 60 days after the first examination following an appeal resolution to make sure that no retaliatory action has been taken by an OCC examiner for an institution's use of the appeal process. This communication is confidential and independent, and we believe that the institutions we supervise are confident that they can respond candidly.

III. Tailored Supervision

The OCC understands that a one-size-fits-all approach to supervision is not always appropriate, especially for community banks. We recognize that community banks have different business models and more limited resources than larger banks. Therefore, where we have the flexibility under the law, we seek to tailor our supervision to a bank's size and complexity, and we factor these differences into the rules we write and the guidance we issue.

The OCC seeks to minimize burden on community banks through various means. Examples of ways in which we tailor our regulations to accommodate community banks, while remaining faithful to statutory requirements and legislative intent, include explaining and organizing our rulemakings so these institutions can better understand their scope and application, providing alternative ways to satisfy regulatory requirements, and using regulatory exemptions or transition periods.

For example, the OCC, Federal Deposit Insurance Corporation (FDIC), and Board of Governors of the Federal Reserve System (Board) jointly drafted the final risk-based regulatory capital rule to reflect the nature and complexity of the different institutions we regulate. Although some provisions in the rule apply broadly, many requirements, including the supplementary leverage ratio and the countercyclical capital buffer, apply only to the largest banking organizations, which engage in the most complex and high-risk activities. We also adjusted the final rule to address significant concerns raised by community bankers by retaining the capital treatment for residential mortgage exposures and allowing community banks to elect to continue the treatment of certain accumulated other comprehensive income (AOCI) components. This treatment of AOCI helps community banks avoid introducing substantial volatility into their regulatory capital calculations. And we continue to explore additional ways to

tailor the capital rules to respond to community bank concerns and proposals, consistent with our objective of ensuring appropriate levels and quality of capital.

The OCC also responded to community bank concerns when we finalized our revised lending limits rule, issued in accordance with section 610 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), to include counterparty credit exposure arising from derivatives and securities financing transactions. Specifically, the rule exempts from the lending limit calculations certain securities financing transactions most commonly used by community banks. It also permits small institutions to adopt compliance alternatives commensurate with their size and risk profile by providing flexible options for measuring covered counterparty credit exposures, including an easy-to-use lookup table.

Our final rule implementing the Volcker Rule provisions of the Dodd-Frank Act is another example of how we seek to adapt statutory requirements to activities at different sized institutions, where possible. The statute applies to all banking entities, regardless of size; however, not all banking entities engage in activities covered by the prohibitions in the statute. One of the OCC's priorities in the interagency Volcker rulemaking was to make sure that the final regulations imposed compliance obligations on banking entities in proportion to their involvement in covered activities and investments. The rule, however, does not exempt community banks from the requirement to assess their activities and determine whether they are covered by the rule. As noted later in my testimony, we have submitted a legislative proposal that would exempt small banks from this rule.

The OCC is constantly seeking to improve how we communicate information to community banks and to provide tools and resources to assist them in identifying and managing their risks. We have designed the bulletins announcing the issuance of each new regulation or

supervisory guidance so that these banks can quickly assess whether the issuance applies to them, and we include a “highlights” section that identifies the key components of the rule or guidance. We also provide plain language descriptions of complex requirements to assist community bankers in understanding newly issued rules. For example, we provided community banks with a quick reference guide to the mortgage rules issued by the Consumer Financial Protection Bureau. We also produced a streamlined, two-page summary of the final domestic capital rule, highlighting aspects of the rule and key transition dates applicable to community banks. We supplemented this summary with an online regulatory capital estimator tool for banks, which we developed with the other federal banking agencies. The agencies augmented the estimator tool with a supplemental tool that banks may use to help calculate regulatory capital requirements for securitization exposures.

In addition, the OCC has focused on providing community banks with tools to assist them in determining whether they are adequately prepared to address cyber threats. This has been a particular emphasis of both the Comptroller and the Federal Financial Institutions Examination Council (FFIEC). Last year, members of the FFIEC, including the OCC, piloted a cybersecurity assessment at more than 500 community institutions to evaluate their preparedness to mitigate cybersecurity risks. The assessment supplemented regularly scheduled exams and built upon key supervisory expectations contained within existing FFIEC information technology handbooks and other regulatory guidance. The agencies subsequently published *FFIEC Cybersecurity Assessment General Observations*,¹ which includes questions for bank management to consider when assessing their institutions’ cybersecurity preparedness. We understand that community banks have found this information helpful in assessing their own

¹ http://www.ffiec.gov/press/PDF/FFIEC_Cybersecurity_Assessment_Observations.pdf.

strengths and weaknesses in this important area. Last month, the FFIEC provided an overview of its cybersecurity priorities for the remainder of 2015, which include the issuance of a self-assessment tool to assist institutions, including community banks, in evaluating their inherent risk and risk management capabilities with respect to cybersecurity.

Through our secure BankNet website, the OCC provides other tools targeted to community banks. These include a portfolio-level stress test tool designed to provide bankers with a simple method to perform portfolio stress testing on income producing commercial real estate loans. OCC examiners developed this optional tool in response to requests from community bankers seeking additional guidance on how to stress test their loan portfolios. Another popular tool allows bankers to develop customized peer reports that they can use to compare their bank's balance sheet and financial performance ratios to those of other banks.

The OCC's *Semiannual Risk Perspective* provides bankers with an analysis of current market and risk trends that may affect their institutions. Because we recognize that community banks may face different challenges than larger banks, the report discusses risks from both a large and small bank perspective. We supplement this semiannual report with periodic webinars, generally targeted to community banks, on emerging risk topics. For example, the FFIEC conducted a webinar for community banks on "Executive Leadership of Cybersecurity." More than 5,000 Chief Executive Officers of community institutions registered for this event. The goal of this and similar webinars is to provide community bankers with practical information to help them mitigate emerging risks and to understand and comply with supervisory expectations.

IV. Other Burden Reduction Opportunities

When considering proposals to reduce burden on community banks, the OCC seeks to ensure that the proposals do not compromise fundamental safety and soundness or consumer

protection safeguards. Within this framework, the OCC is committed to exploring additional ways to reduce unnecessary regulatory burden on community banks. To this end, we are undertaking several regulatory review projects designed to reduce burden, particularly on community banks, and are considering other innovative approaches to address this issue. Late last year, we drafted and submitted three legislative proposals to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs, which provide a statutory basis to revise our regulations and reduce burden on covered institutions, if enacted. These proposals, which I describe below, are the product of both our on-going dialogue with smaller institutions and our supervisory expertise with both large and small banks and savings associations. The OCC would be pleased to share these proposals, as well as our experience and expertise, with this Subcommittee as it considers legislative options to address regulatory burden.

A. Legislative Proposals

Amendments to the Scope of the Volcker Rule. The risks to the financial system of proprietary trading and owning or sponsoring private equity and hedge funds are far more significant when larger institutions engage in these activities than when community banks do so, to the extent they even engage in such activities. Yet, the Volcker Rule contains no exemption for community banks. Accordingly, community banks need to ascertain whether their activities are covered by the Volcker Rule in order to understand whether they have any compliance obligations. Making this determination may require them to expend money and resources — for example, by hiring attorneys and consultants. This regulatory burden is not justified by the risk these institutions present.

In response to concerns raised by community institutions and issues that have arisen during our ongoing Volcker Rule implementation efforts, the OCC drafted a legislative proposal to exempt from the Volcker Rule banks with total consolidated assets of \$10 billion or less. This proposal would eliminate unnecessary burden for small banks while ensuring that we address the risks the Volcker Rule sought to eliminate. Where a community bank engages in activities covered by the current Volcker Rule, the OCC could address any concerns as part of its normal safety and soundness supervisory process. Based on our analysis, we estimate that this amendment could exempt more than 6,000 small banks, including small banks regulated by the OCC, from the requirement to comply with the regulations implementing the Volcker Rule.

Revisions to the Examination Schedule. The OCC generally examines national banks and federal savings associations with total assets greater than \$500 million on a 12-month cycle. We believe, however, that there are additional healthy, well-managed community banks that should qualify for the 18-month examination cycle. Accordingly, the OCC drafted a legislative proposal to increase from \$500 million to \$750 million the asset-size threshold that determines whether a community bank can qualify for an examination every 18 months, rather than every 12 months. The OCC would continue to use off-site monitoring tools to identify potential problems in these low risk institutions and, if warranted, could examine the institution more frequently.

This proposal is consistent with the incremental approach that Congress has taken when increasing the threshold amount of assets that permits small institutions to qualify for the 18-month examination cycle. Furthermore, it would allow the OCC to more appropriately align our supervisory resources with risk, while simultaneously reducing the regulatory burden on small, well-capitalized, and well-managed institutions. We estimate that this amendment would affect more than 400 banks, including banks regulated by the OCC.

I am pleased to see that some Members of Congress, including Representatives Barr and Tipton, have taken an interest in this issue and introduced legislative proposals to expand the examination cycle for additional community banks.

Changes to Permissible Activities for Federal Savings Associations. Currently, the powers of federal savings associations are set out in the Home Owners' Loan Act (HOLA), which establishes lending and investment limits for these institutions. Federal savings associations have told us that they would like to engage in additional activities to serve their communities but are unable to do so because of the HOLA limits. Under existing law, their only option is to convert to a bank charter, a process that can impose costs and burden that we believe can be alleviated.

To address these concerns, the OCC offered legislation that would give a federal savings association a choice: continue to operate as a traditional thrift or file a notice to be treated as a "covered savings association." Generally, a covered savings association would have the powers of and be subject to the same restrictions as a national bank. In practice, this means that a federal savings association that becomes a covered savings association would gain national bank powers but would have to discontinue activities not permissible for a national bank, subject to rules governing non-conforming assets and subsidiaries. This option would provide a federal savings association with the flexibility to retain its current corporate form and governance structure without unnecessarily limiting the evolution of its business plan. If a federal savings association's business plan changed after it became a covered savings association, it generally would be permitted to reverse its election and regain its traditional thrift status after an appropriate period. This option would allow these institutions to adapt to changing economic and business environments and to better meet the needs of their communities. As the supervisor of

both national banks and federal savings associations, we are well-positioned to administer this type of framework given our familiarity with the individual institutions and their governing statutes.

I would like to take this opportunity to express my appreciation for the significant efforts of Representatives Rothfus and Himes, who recently introduced H.R. 1660, the Federal Savings Association Charter Flexibility Act of 2015. If enacted, this bill will bring the type of flexibility and regulatory relief I describe above to our nation's federal savings associations.

B. Current Initiatives

While the OCC calibrates individual regulations to account for differences in the size and complexity of institutions as they are developed, we recognize the need to periodically assess how existing rules can be modified to ease regulatory burden on banks. The OCC has several projects underway, and we are considering other approaches to achieve this goal.

Integration of National Bank and Savings Association Rules. The Dodd-Frank Act transferred to the OCC all functions of the Office of Thrift Supervision (OTS) relating to the examination, supervision, and regulation of federal savings associations. Following the transfer of OTS rulemaking functions to the OCC, we began a comprehensive, multi-phase review of our regulations and those of the former OTS to reduce burden and duplication, promote fairness in supervision, and create efficiencies for national banks and federal savings associations. Last spring, we issued a proposal to integrate our bank and saving association rules relating to corporate activities and transactions into a single set of rules, where possible. Many of the changes included in the proposal would reduce burden for all institutions, including community banks. We are working on a final rule to implement these changes and hope to issue it in the near future.

EGRPRA. The OCC, FDIC, Board, and FFIEC are currently engaged in a review of their regulations, as required by *EGRPRA*. Specifically, the statute requires that, at least once every ten years, the agencies seek public comment on rules that are outdated or otherwise unnecessary. This provides both the agencies and the public with an opportunity to recommend ways to reduce burden.

To carry out the *EGRPRA* review, the agencies plan to publish at least four *Federal Register* notices, each addressing one or more categories of rules. To date, we have published two notices, each seeking comment on three categories of rules. In each notice, we specifically ask the public to identify ways to reduce unnecessary burden associated with our regulations, with a particular focus on community banks. We plan to issue a third *Federal Register* notice soon, seeking comment on three additional categories, followed by one or more additional notices on the remaining rules.

In addition, the agencies recently decided to expand the scope of the *EGRPRA* review in order to be as inclusive as possible. Accordingly, the agencies will solicit comment on all of our regulations issued in final form up to the date that we publish our last *EGRPRA* notice for public comment. We will provide more information regarding this expanded *EGRPRA* review in the next *EGRPRA Federal Register* notice.

The agencies received over 40 comments on the first *Federal Register* notice, and the comment period on the second *Federal Register* notice is still open. We carefully review all comments we receive to identify areas where changes would be appropriate. In addition, we are undertaking our own review of these rules, and the statutes they implement to assess whether there are areas where we can reduce burden without compromising safety and soundness. This

project is very important to the Comptroller, and we are hopeful that it will yield positive results, particularly for community banks.

In addition, the agencies are holding a series of EGRPRA outreach meetings to give members of the public an opportunity to present their views in person. The outreach meetings feature panel presentations by industry participants and consumer and community groups. To date, we have held outreach meetings in Los Angeles and Dallas, and I have participated in each of these meetings to hear first-hand the views and recommendations offered by the many participants. We have a meeting scheduled for next month in Boston, followed by meetings in Chicago and Washington, D.C. We have also scheduled an outreach meeting in Kansas City that will focus specifically on rural banking issues. Recognizing that travel costs may restrict the ability of interested parties to attend in person, we live-stream each outreach meeting, where possible, and provide a video archive of the proceedings to increase the public's opportunity to view the meetings. These resources are easily accessible on the agencies' EGRPRA website, as are the *Federal Register* notices, all comments we have received, and additional EGRPRA information.²

While the EGRPRA process will unfold over a period of time, the OCC will not wait until it is over to implement changes where a good case is made for regulatory relief. Where it is clear that a regulation is outdated, unnecessary, or unduly burdensome, we will act where we have the authority to do so. For example, we are actively reviewing suggestions to eliminate board of director approvals in certain circumstances and to broaden the use of electronic submissions for filing forms. In addition, many of the changes that we included in the integration rulemaking discussed above are consistent with comments we received in the EGRPRA review.

² The EGRPRA website can be accessed at <http://egrpra.ffiec.gov>.

Finally, the EGRPRA review may help us identify burdensome regulatory requirements that derive from statutory provisions. When we identify these provisions, we look forward to sharing our insights and experience with Congress.

Call Report Simplification. The OCC and other federal banking agencies, under the auspices of the FFIEC, are considering ways that we can further tailor reporting requirements for community banks. Recently, we received proposals to reduce the burden associated with the preparation of the Consolidated Reports of Condition and Income (Call Report), including the feasibility of allowing certain banks to file a short-form Call Report for two quarters of a year. The OCC has discussed the Call Report issue in numerous meetings with bankers, and we are committed to carefully considering their concerns.

As part of this effort, the OCC and other federal banking agencies have agreed to undertake a Call Report simplification project through the FFIEC Task Force on Reports. The first step was the development by the Task Force of guiding principles to serve as the basis for evaluating potential additions or deletions of data items to and from the Call Report. Using these guiding principles, the Task Force will undertake a comprehensive review of every line item of every schedule in the Call Report to identify data items that we can delete. The Task Force is also considering the feasibility of a simplified Call Report for certain community banks, as the current version includes schedules and data items not applicable to most of these institutions.

Collaboration. While we expect that the above-referenced projects will reduce burden for many community banks, the OCC is also studying other, less conventional approaches to help community banks thrive in the modern financial world. One especially promising approach involves collaboration between community banks and is the subject of an important paper the

OCC published earlier this year.³ The principle behind this approach, which grew out of productive and on-going discussions between the OCC and our community banks, is that by pooling resources, community banks can manage regulatory requirements, trim costs, and serve customers who might otherwise lie beyond their reach. We have already seen examples of successful collaboration, such as community banks forming an alliance to bid on larger loan projects and banks pooling resources to finance community development activities.

There are many other opportunities of this nature, which can increase efficiencies and save money. As noted in our paper, these include collaboration on accounting, clerical support, data processing, employee benefit planning, and health insurance — to name just a few. Our innovative community banks can undoubtedly find other ways to share resources in a safe and sound manner.

V. Conclusion

Community banks are essential to our nation's communities and small businesses. The OCC is committed to minimizing unnecessary regulatory burden for these institutions. We will continue to consider carefully the potential effect that current and future policies and regulations may have on community banks and will be happy to work with the Subcommittee on any proposed legislative initiatives.

³ *An Opportunity for Community Banks: Working Together Collaboratively*, Jan. 13, 2015.