Remarks by

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Thank you. My predecessors and I have always looked forward to the IIB's annual Washington conference, because it provides an opportunity to engage with industry leaders and to address key policy issues of importance to the international banking community. We also welcome the IIB conference also because of its timing, which tells us that spring cannot be far off. So, for any number of reasons, I'm delighted to be with you here today.

Some of you may know that the OCC's anniversary year, marking 150 years of service to the people of the United States, came to an end a few weeks ago. For our 3,800 employees, it was a year of celebration. But it was also a year of study and reflection. It was an occasion for us to give thought to how much has changed since the days of Lincoln—for both the OCC and the industry we supervise—and about where we are heading as the next chapter of our history unfolds. In fact, later this month, we'll be joining Boston University's Center for Finance, Law and Policy in sponsoring a conference that will bring together a number of the industry's best minds to commemorate our anniversary and explore the challenges facing the industry and its regulators.

The OCC's engagement with the past during this anniversary year repeatedly reminded us of a truth that is often overlooked: that the expansion of international finance and trade have not only been essential to the development of the United States, but were fundamental reasons for its founding.

The extent to which the worlds of international banking and international bank supervision have changed just since the IIB began in 1966 is truly remarkable. Indeed, trade organizations like the IIB and official bodies such as the International Monetary Fund, the Financial Stability Board, and the Basel Committee on Banking Supervision deserve a fair share of credit for broadening financial markets.

Ultimately, the importance of the IIB and the organizations that bring regulators together globally can be seen in the fact that so many of the key challenges facing domestic supervisors can no longer be understood and addressed purely in a domestic context. That is especially true of inherently transnational issues, such as cyber security and our efforts to combat money laundering. But as technology overtakes the payments and credit system, with the rise of person-to-person, non-intermediated lending, the issues we face as regulators transcend national boundaries, and call for a greater degree of collaboration and cooperation among supervisory bodies.

It was in that spirit that the OCC last fall brought together a team of senior international regulators to conduct an independent assessment of our supervision program for large and midsize banks and thrifts. The participating countries were Singapore, Australia, and Canada—countries with financial systems that had demonstrated particular resilience during the crisis. Jonathan Fiechter, whose distinguished career has included senior-level stints at the Office of Thrift Supervision, the OCC, and the International Monetary Fund, headed the team.

The Fiechter group submitted its report in December. While generally complimentary of the OCC's supervisory program and the caliber of our people – who are top notch – the report offered a number of suggestions for improving the agency's structure, culture, and procedures. These included enhancing our risk identification capabilities, making supervisory ratings more forward-looking, and adopting a more flexible approach to the deployment of examiners and lead experts across the banks we supervise, to ensure that the key supervisory decisions are objective and consistent.

These recommendations were much appreciated. The OCC is a very strong supervisory agency, but that's only because we have been willing to engage in a process of continual improvement. That's why our staff was so quick to embrace the work of the international peer review team. Two OCC task forces are reviewing the report and developing plans based on its recommendations, so it's hard to predict exactly where they will lead us—except, I am certain, to an even stronger OCC. Exercises like this, which take advantage of the unique experiences of regulators in other countries and their different approaches to bank oversight, offer the opportunity to strengthen supervision – and the financial system – globally. The challenges of the modern era demand that we continually seek ways to improve, and cross-country collaboration is crucial to the achievement of our shared goal of a safe and sound international banking system.

It seems only right that we should be demanding more of ourselves as regulators since we are demanding more of our banks. While we were still cleaning up after the financial crisis, we were already looking ahead at ways to prevent future breakdowns.

One important initiative we undertook was to develop a program of “heightened expectations” for our largest, more complex institutions. We have continued to refine these expectations since then. They encompass a range of risk management and governance capabilities that, as recent experience teaches us, must be maintained at the highest levels to protect institutions from potentially catastrophic breakdowns. Among other things, we began to insist that internal controls and audit be raised to the level of “strong,” and we made it clear that ratings that are merely satisfactory are no longer acceptable. We told boards of directors that they had to be significantly engaged in the formulation and execution of bank policies and practices, and that they had to be prepared to offer a credible challenge to management. We insisted that banks put in place a rigorous process to attract and retain the kind of talent they need to manage their business in a safe and sound manner.

In January, we took our heightened-expectations program a step further by proposing a rule that further refines and formalizes these higher standards for risk management and governance. Among other things, the proposed rule, which would become enforceable under Part 30 of the agency’s regulations, outlines the roles and responsibilities of organizational entities fundamental to the design and implementation of the risk governance framework: front line units, independent risk management, and internal audit. Together these units represent the three lines of defense a bank must maintain to protect it in the event of adverse circumstances.

The proposed rule requires banks to develop a comprehensive written statement articulating their risk appetite, which in turn will serve as a basis for a risk governance framework. It requires board members to monitor their bank’s activities to ensure that they are consistent with the institution's risk appetite—and to question, challenge, and oppose management proposals that could lead to excessive risk taking or pose a threat to safety and soundness. At least two of those board members would have to be independent of management.

I should emphasize that the proposed rule applies to any insured OCC-supervised institution with $50 billion or more in assets. This threshold would generally exclude existing insured Federal branches of foreign banks. Nonetheless, the OCC reserves the authority to apply the rules to an ensured entity, including a Federal branch, irrespective of asset size, if that entity has operations that are highly complex or present heightened risk.

It is important to note that uninsured Federal branches, which constitute the vast majority of Federal branches, would not be covered by the proposal. However, the OCC is informally applying certain aspects of heightened expectations to a few uninsured Federal branches with highly complex operations or heightened risk, and we expect that to continue.

One potential obstacle to effective risk management and corporate governance is the multiplicity of legal entities within banking organizations. This is a potential safety and soundness concern, and one that we take very seriously. The proliferation of legal entities within a banking organization adds greatly to the complexity of the company and measurably increases the difficulty of managing it. And in the event of a failure, a multitude of separate legal entities would make it much more difficult for the FDIC to wind down a company under its orderly liquidation authority. In 2008, when Lehman Brothers collapsed, regulators found it next to impossible to identify all the counterparties that were exposed to the bank and, in turn, to each other. Senior policymakers had to hold their collective breath when that and other major Wall Street events took place, because they had no reliable way of determining who would be affected and in what way.

Scrubbing the organization chart is an exercise that is particularly important for the largest banking organizations, which are required to develop acceptable recovery and resolution plans that address two key questions. The first is how the bank would meet a crisis—for example, a sudden loss of liquidity or deterioration of asset quality— while the second involves the steps management would take to recover from extraordinary stress. Obviously, this would become considerably more difficult for institutions with lines of business that cut across hundreds or thousands of legal entities. As the supervisor for many of the nation's largest financial institutions – and as a member of the FDIC's board of directors, I take this concern very seriously.

Not surprisingly, then, many large OCC-supervised banks are reexamining their organizational structures and launching plans for legal entity simplification. The cost of developing these plans can be significant, but the long-term benefits to the bank and more importantly to financial stability can be even greater. On the operational side, rationalizing legal entities offers the prospect of reducing legal and regulatory expenses, containing finance and treasury costs, and controlling accounting fees. Instead of dealing with multiple vendors, or vendors doing business separately with multiple legal entities of the same enterprise, the bank can consolidate its contracted business and reap the savings. There can be enormous potential benefits in terms of system integration, which not only should reduce cost and complexity but also make the bank better able to meet regulatory requirements for compliance with, for example, Bank Secrecy Act and data security standards.

I have only touched upon the considerable operational and cost savings benefits of legal entity simplifications. But from a risk management and governance standpoint—the object of OCC's heightened expectations—legal entity simplification can yield even greater differences. Regulators and boards of directors necessarily are concerned about the viability of the legal entities that comprise an organization. During times of stress, having a clear path to recovery and the operating flexibility to implement the plan is a critical requirement to success. In that context, legal entity simplification can enable operating flexibility at just those times when it is most valuable to the organization

Moreover, we have observed that the banks going through the legal entity simplification process are the ones making noticeable progress in meeting our heightened expectations around risk management and governance.

The majority of OCC-supervised banks with complex structures are now engaged in simplification projects, and we are strongly encouraging this process. We plan to initiate a project soon to compile data that will assist the industry and other regulators in assessing the impact of these actions. We expect this project to provide insight on the impact of legal entity simplification on resolution and recovery planning as well as ongoing risk management.

The three initiatives I have discussed with you today—the OCC's peer review, its proposed rule on heightened expectations, and legal entity simplification—are different in many ways, but they also have much in common. All three are designed to address problems that played a role in the financial crisis. Two of them—the peer review and the legal entity simplification project—underscore our commitment to international cooperation, formal and informal. The OCC's heightened expectations remind us that, even as we push ahead in the interests of raising supervisory standards, sovereign states have a responsibility to shape their financial systems in ways that reflect each country's unique needs and habits.

We at the OCC very much appreciate your support of these goals, as well as the time you have given me today. I'd be more than happy to take some of your questions.