Remarks

by

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Regarding

OCC's *Semiannual Risk Perspective*, Spring 2017

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Good afternoon. I want to thank all of you for calling in and covering our *Semiannual Risk Perspective* for Spring 2017. The *Semiannual Risk Perspective* has become a "must-read" report for our industry since the agency began issuing the report publicly five years ago. Producing such a valuable and important report takes extensive effort. I want to express my gratitude to the dozens of people at the Office of the Comptroller of the Currency (OCC) who work so hard to deliver this report twice each year. I am joined on this call by a few of them who will be helping to answer your questions.

Before we begin to discuss the risks identified in this report, let me say how honored I am to serve as the Acting Comptroller of the Currency until the Senate confirms the 31st Comptroller. The OCC supervises about 1,400 national banks, federal savings associations, and federal branches of foreign banks. The institutions that make up the federal banking system hold an aggregate of approximately $11.4 trillion in assets, or more than two-thirds of all assets of U.S. commercial banks and savings associations. The vast majority of those institutions—more than eleven hundred—are community banks with under $1 billion in assets. The system includes the country's largest and most complex banks as well.

The federal banking system is, and should be, a source of strength for the nation and its economy. When it is running well, it powers tremendous growth and economic prosperity for consumers, businesses, and communities across the country. Our job is to find that balance where supervision effectively ensures safety, soundness, and compliance but does not stifle opportunities through unnecessary burden or foster an environment so risk averse that banks fail to meet the credit needs of their customers. This report is part of that effort. By identifying risks and increasing our shared understanding of those issues, the report can help to improve the entire industry's readiness to respond to and manage emerging risks.

Today, the federal banking system remains healthy. As outlined in the report, however, the OCC again identifies issues related to strategic, credit, operational, and compliance risks as top concerns. While these are risks that the system faces as a whole, we note that the risks differ from bank to bank based on size, region, and business model. Compliance, governance, and operational risk issues remain leading risk issues for large banks while strategic, credit, and compliance risks remain the leading issues for midsize and community banks. The OCC employs a risk-focused approach to supervision and tailors examination strategies to the individual risks of each of its supervised institutions and will pay close attention to these key risk areas over the next six months.

Let me now discuss the specific risks detailed in this report. First, strategic risk is elevated, as banks make decisions to expand into new products or services, consider new delivery channels, or otherwise search for sustainable ways to generate returns in a persistent low interest rate environment. Net interest margins remain under pressure despite recent increases in the Fed funds rate. As the Federal Reserve increases its rates, we see a need for banks to be aware of how their strategic decisions and balance sheet structure may affect earnings.

Second, credit risk is relatively stable overall. Nonetheless, we must remain vigilant. We continue to see more banks easing underwriting practices across commercial and retail products as they strive for growth amid heavy competition. As noted in the report, commercial real estate (CRE) growth in some banks has been accompanied by weaker structures and eased underwriting. Banks' concentrations in CRE continue to increase, at a more moderate pace, with the largest CRE concentrations occurring in community and midsize banks. In addition, our examiners have noted weaknesses in concentration management of CRE. We are also closely monitoring credit risk associated with auto lending, agriculture, leveraged loans, and banks' credit loss reserves.

Third, operational risk remains elevated as we see more sophisticated cybersecurity threats and the need for sound governance over product service and delivery. Cybercriminals are using a variety of evolving tactics, including sophisticated ransomware variants, denial-of-service, business e-mail compromises, and theft of sensitive business and customer information in extortion schemes. It remains critical that banks focus on employee awareness of phishing schemes and keep all system patches up to date. Effective risk management promotes timely detection, response and escalation of operational issues to reduce customer impact due to product failures, possible fraud, and potential unfair or deceptive acts or practices. We note that control breakdowns in the governance of product sales, delivery, and services can erode trust in the banking system.

Finally, with respect to compliance risk management, the report notes that our examiners continue to see banks struggle with both consumer and Bank Secrecy Act (BSA) compliance. Evolving compliance risks and increasing complexity of the risk environment present significant challenges for bank compliance risk management systems. Some banks also face change management challenges as they adapt to new or amended consumer-focused regulations. These regulations include the integrated mortgage disclosures under the Truth in Lending Act and Real Estate Settlement Procedures Act, the new requirements under the amended regulation implementing the Military Lending Act, and pending changes to the data collection and processing rules for the Home Mortgage Disclosure Act. At the same time, banks continually have to improve their BSA monitoring and detection capabilities as money launderers and terrorist financiers find new ways to exploit the financial system.

Before closing, I also want to highlight the agency's role in supervising major service providers that support the federal banking system. The OCC conducts examinations of services provided to banks by third-party service providers, including technology service providers, based on authorities granted by the Bank Service Company Act, and the Home Owners' Loan Act. Examinations of significant service providers typically are coordinated with the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and other agencies or regulators with appropriate legal authority. Supervisory priorities at these entities are key technology and operational controls and other risk management functions including cybersecurity, enterprise risk management, third-party risk management, change management processes, and management of product- and service-specific risks. Service providers are an important part of the banking ecosystem and are critical to the continued operation of a healthy system.

I hope you will take time to read the rest of the report. Now, I will turn it over to Deputy Comptroller for Supervision Risk Management Darrin Benhart who can add some color around these issues before opening it up for questions.