

Remarks

By

Keith A. Noreika  
Acting Comptroller of the Currency

At the

Midsize Bank Coalition of America  
Chief Risk Officer Meeting

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Greetings. Thank you having me here today. It's my pleasure to join you and share my perspective on a variety of topics that are important to midsize banks and the federal banking system more broadly. Like my tenure as Acting Comptroller, I won't take up too much time and I'll leave plenty of time for those who follow me. In the few minutes that I have with you, I want to share my optimism for meaningful regulatory reform in a few key areas while maintaining the safety and soundness of our banking system and discuss the key risks we continue to see for national banks and federal savings associations.

I think we have good reason for optimism. Today, we are having conversations that would have been impossible just a few months ago. Since taking on this role, I have been encouraged by the appetite for change among OCC staff, other regulators, and on Capitol Hill. We need to remember that a healthy bank is a safe *and* sound one, as former Acting Comptroller John Walsh once told me. That means banks must be able to function in ways that satisfy their intended purposes of lending and meeting the banking needs of the consumers, businesses, and communities they serve. We can't create a system so risk averse that we squeeze opportunity out of that system.

There are many people on the Hill who agree and are interested in rebalancing our regulatory framework. I have had at least 10 frank and productive conversations with members of the House and Senate, from both sides of the aisle. Across the board, they are interested in ideas for meaningful reform.

During my first week at the OCC—actually on my third day—I met with the Chairman of the Senate Banking Committee to talk about how we could recalibrate some of the statutory obligations banks face without adversely affecting safety and soundness. A few weeks later, when I testified before the Senate Banking Committee, I shared 17 ideas for Congressional consideration that have since been widely distributed on Capitol Hill and in the press.<sup>1</sup> These ideas included proposals to minimize regulatory inefficiency, “right-size” regulation, and provide regulatory certainty in areas such as the “valid when made” doctrine that was erroneously decided in the Second Circuit’s decision in *Madden v. Midland Funding*.

Fixing Volcker is at the top of the list for a lot of people, and I am encouraged by the openness on Capitol Hill to consider some needed changes. For example, there are proposals in the House and Senate to repeal the Volcker Rule or carve certain types of banks out of the Volcker Rule. There is also broad support for regulators to recalibrate the rule. To help inform that process, the OCC published a request for comment on ways to improve the implementation of the Volcker Rule.<sup>2</sup> The comment period closed on September 21, and we are reviewing those comments now.

Another area where I have seen increasing Congressional interest is in the area of capital simplification. Late last month, the OCC, FDIC, and Federal Reserve solicited feedback on

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<sup>1</sup> See Testimony of Keith A. Noreika, Acting Comptroller of the Currency, Before the Committee on Banking, Housing, and Urban Affairs. U.S. Senate. June 22, 2017 (<https://www.occ.gov/news-issuances/news-releases/2017/nr-occ-2017-71b.pdf>).

<sup>2</sup> See “OCC Solicits Public Comments on Revising the Volcker Rule.” NR 2017-89. August 2, 2017 (<https://www.occ.gov/news-issuances/news-releases/2017/nr-occ-2017-89.html>).

several proposed changes on the capital treatment for particular assets that would apply to banks of all sizes.<sup>3</sup> For non-advanced approach banks, the agencies are proposing a simpler regulatory capital treatment for mortgage servicing assets, certain deferred tax assets, investments in the capital of unconsolidated financial institutions, and capital issued by a consolidated subsidiary of a banking organization and held by third parties. More generally, the proposal would replace the current, complex treatment of high-volatility commercial real estate exposures with a more straightforward treatment for most acquisition, development, or construction loans. The proposal includes other clarifications and technical amendments, which would apply to both non-advanced approaches banks and advanced approaches banks. We believe these changes will go a long way in right-sizing those capital rules that are unduly complicated. I invite you to review and comment on the joint proposal. I am sure your banks' trade associations will not be shy about commenting.

Another example involves harmonizing guidance and policies regarding cybersecurity to ensure that our financial system can effectively prevent cyber events and respond quickly when incidents occur. We recognize that there are numerous regulations and agencies with cyber oversight. Rather than having a positive additive effect, the crowded regulatory space could result in confusion and even conflicting requirements. Those are the last things you need when responding to potentially systemic concerns. The OCC is very active in interagency groups advocating for harmony to ensure that all guidance is clear and actionable.

Harmonizing other regulatory activity is important, too. Often multiple regulators overlap in unhelpful ways. That can lead to confusion and conflicting regulatory guidance. That's why

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<sup>3</sup> See "Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996." September 27, 2017 (<https://www.occ.gov/news-issuances/news-releases/2017/nr-ia-2017-111a.pdf>).

my testimony before the Senate in June included a suggestion to create a system of regulatory “traffic signals” to better coordinate activity of multiple regulators at a particular institution.

Another area I want to mention is asset thresholds and my personal view that arbitrary thresholds often have the perverse effect of acting as competitive barriers. Even famous large bank CEOs see the disparate treatment of the largest banks and various thresholds that exist as widening the moat around those institutions, protecting them from competition.<sup>4</sup> At the same time, we see a phenomena in which banks want to stay at \$9 billion or \$49 billion because they would incur additional costs and unwelcome scrutiny merely crossing that threshold. In practice what we see are banks either remaining below the threshold or leaping far beyond the threshold. So rather than becoming an \$11 billion bank, the incentive is to rapidly scale to \$20 billion or \$30 billion to offset the increased cost just north of the threshold. That’s an artificial reason to grow so quickly and could present operational and other risk issues for banks that do.

One place where we see thresholds having adverse effects is in the requirements associated with the stress tests required under Dodd-Frank. Section 165 of the Dodd-Frank Act requires an annual stress test for all banks with assets of more than \$10 billion, and limits regulators’ flexibility to determine when and within what parameters a stress test should be conducted. In certain circumstances, the burden of annual stress testing, particularly in accordance with prescriptive statutory requirements, is not commensurate with the systemic risks presented by an institution. There is tremendous diversity in the business models of banks around \$10 billion, and regulators need the ability and authority to tailor their supervision to the unique

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<sup>4</sup> See Tanya D. Marsh and Joseph W. Norman, “Reforming the Regulation of Community Banks After Dodd-Frank.” American Enterprise Institute. May 2013. Marsh and Norman note the widely cited conversation between Citi Analyst Keith Horowitz and JPMorgan Chase CEO Jamie Dimon in which Mr. Dimon sees “higher capital rules, Volcker, and OTC derivative reforms longer-term make it more expensive and tend to make it tougher for smaller players to enter the market, effectively widening JPM’s ‘moat.’ While there will be some drags on profitability.”

risks presented by individual banks. For banks looking to cross the \$50 billion threshold, the many rules currently in place—the DFAST/CCAR regime is just one example—pose other impediments, as the work and cost to prepare for these many requirements present real costs for banks, even before actually crossing the threshold.

The Treasury Report on Core Economic Principles recommends raising the threshold for stress tests from \$10 billion to \$50 billion, recognizing that institutions of this size generally do not present the risks that require annual stress testing.<sup>5</sup> In addition, the Report would grant the banking regulators authority to further calibrate the threshold for banks above the \$50 billion threshold to account for risk and complexity.

Another option to address this issue would be for Congress to give the federal banking agencies broad authority to tailor by rule the statutory stress testing requirement, without regard to an asset threshold. This approach would avoid the potential for over and under inclusiveness associated with fixed-asset thresholds. It also provides regulators flexibility to calibrate rules and requirements to be commensurate with the systemic risks presented by individual or groups of institutions.

Before switching gears to talk about the risks facing the federal banking system, I want to discuss further how we are working to ensure regulation is balanced and appropriate by speaking up when we see proposed rules that may adversely affect the business of banking, have systemic effects, or result in perverse unintended consequences. One such example is the Consumer Financial Protection Bureau's (CFPB) final rule on arbitration agreements. When the Bureau was finalizing the rule early this summer, I asked Director Cordray to hold off so that the OCC could conduct an independent review of the data and analysis used to develop and support the rule. I

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<sup>5</sup> See *A Financial System that Creates Economic Opportunities: Banks and Credit Unions*. U.S. Department of the Treasury. June 2017 (<https://www.treasury.gov/press-center/press-releases/Documents/A%20Financial%20System.pdf>).

had questions regarding the impact of the rule on the safety and soundness of community banks and its effect on consumers that their analysis did not answer.

The Bureau pushed ahead anyway and published its final rule on July 10<sup>6</sup> and only later provided the OCC the data and analysis for our review. In September, OCC economists completed their review. Our economists found that despite the CFPB's statement that analysts could not find any evidence to indicate that banning mandatory arbitration agreements would increase costs to consumers, the Bureau's data *actually* shows that there is an 88 percent chance of the total cost of credit increasing, *and* the expected increase is almost 3.5 percentage points.<sup>7</sup> That means a consumer, living week to week, could see the average credit card rate of 12.5 percent jump to nearly 16 percent. That 25 percent increase in the consumer's cost of credit is a significant economic impact, particularly when it is unclear that the rule will achieve its ultimate goal of greater compliance and fairer treatment of consumers by financial institutions.

In addition to the likely adverse effect on consumers, I continue to hear from community bankers that the increased costs of fighting spurious lawsuits shrink their already tight margins. I am told that such legal costs, and the mere threat of such legal costs, could threaten the very existence of small banks that do not have the same financial and legal resources of larger institutions—all because a rule could unleash frivolous, but costly litigation risk. Consumers deserve better, and so do small and midsize banks. Consumers and banks should continue to have that option to resolve contractual differences in the same manner as they do today.

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<sup>6</sup> See <https://www.consumerfinance.gov/policy-compliance/rulemaking/final-rules/arbitration-agreements/>.

<sup>7</sup> See "Probable Cost to Consumers Resulting from the Consumer Finance Protection Bureau's Final Rule on Arbitration Agreements." OCC. September 20, 2017 (<https://occ.gov/publications/publications-by-type/other-publications-reports/occ-arbitration-study.pdf>).

While I am optimistic about opportunities for regulatory reform and promoting economic opportunities, it is still important for us to maintain our vigilance toward key risks facing your institutions and the federal banking system as whole.

The OCC spends a significant amount of effort identifying, assessing, and communicating these risks to bankers, examiners, and other industry stakeholders through a variety of public reports and outreach opportunities. The *Semiannual Risk Perspective* is one of the principal tools we use.<sup>8</sup> This report highlights key risks facing the federal banking system and our supervisory priorities.

The most recent report again indicated the key risks facing institutions within the federal banking system involve strategic, credit, operational, and compliance risk. Strategic risk remains elevated as banks make decisions to expand into new products or services or consider new delivery channels, conduct merger and acquisition activity, and compete with banks and new entrants to the financial service space. And in the challenging and increasingly competitive environment, strategic risk is a concern too for those banks that choose to maintain the status quo.

Credit risk remains elevated as commercial and retail credit underwriting has loosened, showing a transition from a conservative to an increasing risk appetite as banks strive to achieve loan growth and maintain or grow market share. Results from recent supervisory activities raise concern over the quality of CRE risk management, as midsize banks have seen significant growth in CRE the past 2-3 years, shifting from multifamily to retail sector projects.

Operational risk covers a broad number of concerns, including increasing cyber threats, reliance on concentrations in significant third-party service providers, and the need for sound

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<sup>8</sup> See <https://www.occ.gov/publications/publications-by-type/other-publications-reports/index-semiannual-risk-perspective.html>.

governance over product service and delivery. One operational issue that crosses over into compliance risk involves banks' implementation of effective programs to comply with the Bank Secrecy Act that helps protect our financial institutions and system from being exploited for illegal activities such as money laundering and terrorist financing.

On the compliance risk front, complying with BSA remains difficult for some banks. Other compliance challenges banks face include adapting to the integrated mortgage disclosures under the Truth in Lending Act and Real Estate Settlement Procedures Act, the new requirements associated with implementing the Military Lending Act, and changes to the data collection and processing rules for the Home Mortgage Disclosure Act. These are risks that may sound very familiar to you and will be the focus of our exam teams in the next 6-12 months.

Before I close, let me put in one plug for the teams of professionals assigned to supervise your institutions. Every one of them is dedicated to providing the best supervision possible, and I encourage you to take advantage of the staff assigned to your institution. Deputy Comptrollers Bill Haas and Scott Schainost, your examiner-in-charge, and their teams welcome your questions and can provide valuable insight based on their experiences. Good open communication among bankers and the examination team are key to effective supervision.

Thank you again for having me here, and I'd be happy to answer as many questions as time permits.