Remarks

By

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Before the

2013 Association of Military Bankers of America
Charlottesville, Virginia

September 9, 2013

Good morning, it is an honor to be with you today. General Egeland, Andy, thank you for inviting me again to speak with your group. I have great respect for your organization, its members, its mission, and above all, the uniformed men and women who your organization serves. I know everyone in the room joins me in having a sense of deep gratitude for all of the people in our armed services, after all, it is that *service* that separates these particular banking customers from all the other customers your banks support. It is their *service* that creates special needs, unique requirements, and, in some cases, unique protections under the law. It is only appropriate that an organization like this one exists to *serve* those who are willing to sacrifice so much on our behalf. I applaud each of you for taking this responsibility seriously and being active in such an important organization.

It's also an honor to follow retired Air Force General Craig McKinley, now president of the Air Force Association. I know you are busy preparing for your own big event coming up next week in Washington, D.C to celebrate the Air Force's *66th year* of defending the high ground. It is indeed a milestone worthy of celebration, and I offer my congratulations. At the Office of the Comptroller of the Currency, we are celebrating a little anniversary of our own this year—*150 years* of working to keep the federal banking system safe and sound. In 1863, President

Abraham Lincoln signed the National Currency Act establishing the federal banking system and creating the OCC to regulate and supervise it. Calling the system a great benefit to “the people,” President Lincoln declared in his 1864 state of the union address that the national system “will create a reliable and permanent influence in support of the national credit and protect the people against losses in the use of paper money.” We have spent the last 150 years trying to live up to those high expectations.

Today, we continue to feel President Lincoln’s legacy in a system that includes more than 1,800 banks, savings associations, and federal branches of foreign financial institutions that hold more than $10.2 trillion in assets, or about 69 percent of all the assets in commercial U.S. banks. These banks include the very largest multinational banks in our country as well as nearly 1,600 community banks around the country with a billion dollars or less in assets. Large or small, banks and savings associations play an important part in all of the communities they serve—enabling families to save and finance important purchases, as well as lending to companies large and small to keep Main Street in business.

A community is not necessarily geographic, as your military customers know all too well. Community is a binding force that builds identity and shared values. Certainly wherever they serve, members of the military and their families are part of a unique and strong knit community. As military bankers, you must respect and understand that particular community’s needs, honor its members’ service, and build trust through demonstrating a sustained record of commitment to *serving* them.

To meet the needs of the military community and all the communities your banks and thrifts serve, your institutions must adapt their strategies to a constantly changing business and regulatory environment, develop a comprehensive understanding of the associated risks, and implement effective, sustainable approaches to business. This morning, I want to highlight a few particular concerns that we are currently focused on—and mention some of the OCC resources that are available to help national banks and federal savings associations navigate those challenges.

The *OCC Semiannual Risk Perspective* gives insight into what the OCC sees as the biggest risks facing both community banks and large banks.[1] Pulling together data from public sources and the OCC's own supervisory systems, the OCC publishes the *Risk Perspective* twice a year. The most recent edition of the *Perspective* came out at the end of June and is available on our public Web site—occ.gov. The June edition discusses broad risk themes the agency is seeing within the federal banking system and I'd like to take a few minutes to touch on two of them.

First and foremost, banks of all sizes continue to face strategic risk as management searches for ways to generate acceptable returns in an evolving operating environment. Depressed loan demand, coupled with the extended low rate environment is limiting opportunities to improve interest income. Noninterest income is also lagging pre-crisis levels. Banks must proceed carefully as they evaluate potential strategies to diversify their balance sheets and revenue sources. The search for alternative sources of revenue can lead banks to offer new products and services with unfamiliar risks. Proceeding down that path without sufficient due diligence to ensure the requisite expertise, information systems, and controls are in place can result in unforeseen problems that outweigh the anticipated rewards.

A particular area of focus needs to be the reputation and compliance risk associated with new products. Whether the product is prepaid cards, overdraft protection or direct deposit

[1] See *The OCC Semiannual Risk Perspective* (http://www.occ.gov/publications/publications-by-type/other-publications-reports/index-semiannual-risk-perspective.html).

advances, banks must take care to ensure it is offered in a fair manner that discloses the risks and real costs so customers can understand what they are purchasing.

Our examiners have been instructed to include reviews of new products and services that either have been launched, or are being planned, when scoping their exam work. They will assess the management of safety and soundness risks, as well as compliance with applicable consumer protection laws. Where we find issues, we will take the appropriate corrective action.

The second broad theme is operational risk. The Comptroller has been emphasizing the importance of understanding and managing operational risk since his appointment in April of last year. He has explained that operational risk involves "the risk of loss due to failures of people, processes, systems, and external events." That covers a broad range of possibilities, so in the interest of time, I want to highlight just two—the risk associated with weak cyber security and the risk associated with failing to comply with the Bank Secrecy Act (BSA).

Cyber security is a growing concern for banks of all sizes. We are seeing increasingly sophisticated cyber threats at the same time banks are expanding their reliance on technology and third party service providers. The increasing volume and sophistication of cyber threats requires heightened awareness and appropriate resources to identify and mitigate the associated risks. Failures in cyber security can reduce the availability of online and mobile banking services, and, more significantly, result in identity theft and fraud. This has to be a top priority for military bankers since your customer base is even more dependent on online and mobile banking services than the civilian population.

Larger banks have focused on cybersecurity for a number of years, but we are also working to increase awareness and preparedness among smaller banks. As active duty and retired military people know well—defenses are only as strong as the weakest link. As the larger players implement stronger security measures, hackers and other illicit actors are naturally looking for the easier access points into the financial system. They understand just how interconnected the banking system is, and they know no borders or boundaries. Toward that end, we recently hosted a teleseminar for community banks to discuss the evolving cyber landscape.[2] During the presentation, we stressed that senior management needs to be engaged to set the "tone from the top" and ensure that they approach preparedness as a bank-wide endeavor. The webinar included practical advice on how to identify, monitor and respond to cyber threats and vulnerabilities. The recording and a transcript of the cyber security webinar, along with the presentation, are available to national banks and federal savings associations on the OCC's secure site for bankers—BankNet.

At the same time cyber threats are on the rise, some banks are examining ways to reduce expenses and are changing the way they apply technologies, including adopting new and less market-tested applications, reengineering business processes, and increasing their use of outsourcing. These changes may make good business sense and can help a bank reduce costs, operate more efficiently, and provide greater service to its customers. But bank management must also carefully consider and understand the associated risks as a bank makes multiple changes that may result in unintended consequences. Business process reengineering to reduce operating costs may adversely affect compliance, audit, risk management, operations, or internal control mechanisms.

The second operational risk that I want to highlight today involves the risks created by inadequate systems to detect and prevent money-laundering activity. Many of you can draw on your military experience in sizing up this risk. We know that the enemy, in this case the people trying to exploit the nation's banks for illicit and illegal purposes including helping to fund terrorism, is constantly testing our defenses for the weak spots. While historically threats centered on larger internationally active banks—as those defenses improve, the bad guys move to the next opportunity – the same trend that I just mentioned relative to cyber threats. Not only is money-laundering occurring in a wider array of banks, the activities are evolving. Illicit actors are constantly increasing the sophistication of their methods.   These issues can be compounded by a lack of sufficient resources devoted to BSA compliance at the same time as there's pressure to reach for revenue by offering higher-risk products or bringing a higher-risk customer base into the bank. Fighting money-laundering threats while increasing revenue is an area where banks must be particularly vigilant. To borrow the motto from General McKinley's National Guard, financial institutions must be "always ready, always there." In the case of BSA compliance efforts, it's not just about managing regulatory risk—it is about protecting our national security.

I want to leave time to answer all of the questions that I'm sure you have. But, before we get to the questions, I want to talk just a bit about the new capital rules that were finalized in July and the proposed rule on leverage ratios. After all, regulatory capital requirements are all about improving the "financial readiness" of individual institutions and the broader system.

In finalizing the rules, regulators carefully considered the thousands of comments they received, and I believe the changes we made are responsive to those comments. First, the new capital rule does not change the current treatment of residential mortgage exposures. This was an important issue for many community banks who were concerned about the recordkeeping burden as well as the potential impact on their ability to continue to meet the credit needs of their customers.

Second, banking organizations that are not subject to the advanced approaches capital rules can opt not to incorporate most amounts reported as Accumulated Other Comprehensive

Income (or AOCI) in the calculation of their regulatory capital. This option is consistent with the treatment of AOCI under the current rules and helps all but the very largest banking organizations avoid volatility in their regulatory capital requirements.

Third, smaller depository institution holding companies—those with assets less than $15 billion—and certain mutual holding companies—regardless of asset size—will be allowed to continue to count most existing Trust Preferred Securities that were issued prior to May 19, 2010, as Tier 1 capital rather than phasing such securities out of regulatory capital. This treatment will provide greater consistency with related provisions of the Dodd-Frank Act that limit inclusion of such securities in regulatory capital.

While the largest internationally active banking organizations, which are subject to the advanced approaches provisions of the new capital rule, are required to comply with the provisions on January 1, 2014, the deadline for the rest of the banking industry was pushed out until January 1, 2015.

To help smaller, less complex institutions to understand and implement the final rule, the OCC published a "quick reference" guide that summarizes the impact of the new rule on community banks in two pages. Reducing a 900-page rule to a two-page quick guide should tell you how seriously the OCC took into account the comments we received from community bankers. The guide is available on our Web site, OCC.gov.

When the regulators issued their final rules, we also issued a proposed rule that would double the leverage ratio for large interconnected U.S. insured depository institutions. Under the proposed rule, bank holding companies with more than $700 billion in consolidated total assets or $10 trillion in assets under custody would be required to maintain a tier 1 capital leverage buffer of at least 2 percent above the minimum supplementary leverage ratio requirement of 3 percent. If the holding company fell below the 5 percent ratio, it would face restrictions on discretionary bonus payments and capital distributions. The proposed rule also would require those insured depository institutions to meet a 6 percent supplementary leverage ratio to be considered "well capitalized" for prompt corrective action purposes. The proposed rule would currently apply to the eight largest, most systemically significant U.S. banking organizations. The proposal, if adopted, would take effect on January 1, 2018, concurrent with the 3 percent minimum supplementary leverage ratio requirement in the new capital rule.

Combined, the new capital rules and the proposed rule are designed to improve the quantity and quality of capital in our financial system. A strong capital base at the largest, systemically significant U.S. banking organizations is particularly important because capital shortfalls at these institutions have the potential to result in significant, adverse economic consequences and contribute to systemic distress both domestically and internationally.

I want to thank Andy again for inviting me to be a part of this event. Highlighting your role as bankers to our country's military members and families is important. It's a role that you can be proud of and it's a role that carries additional unique responsibilities. As you look for ways to help foster the "financial readiness" of your customers, I encourage you to reflect also on your own "financial readiness" by sharpening your business strategies and by ensuring that you have an effective, systematic approach to identifying and assessing the risks facing your institutions. Today's business environment is exceptionally challenging and in any "theater of operations," it is important to identify your allies. The examiners who supervise your bank can be helpful allies in successfully addressing these challenges by ensuring that you are operating in a safe and sound manner and that you understand the expectations that accompany new rules and regulations. I encourage you to take advantage of the resources I highlighted and to reach out to the OCC for answers and guidance. Those of you from large and midsize banks have dedicated teams of examiners who are always available to answer your questions. Similarly, each community bank or thrift has both an assigned portfolio manager and a local Assistant Deputy Comptroller who are familiar with your institution. If they don’t know the answer to your question, they can quickly plug into our national network of resources and find someone who does. Open communication is a key to our effectiveness as supervisors and can be of real value to you too. I thank you for listening and look forward to answering your questions.