Remarks by

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Good morning. I am Marty Pfinsgraff, Deputy Comptroller for Credit and Market Risk at the Office of the Comptroller of the Currency. For nearly 150 years, the OCC's mission has been the safety and soundness of the national banking system. Last year, pursuant to Title III of the Dodd-Frank Act, the OCC also assumed responsibility for overseeing all federal savings associations

I oversee a policy unit that issues supervisory guidance for bankers and examiners, advises OCC senior management on complex supervisory issues and emerging risks. In that latter role one of my duties is to co-chair the OCC's National Risk Committee, a cross-functional body that monitors risks to the banking system and helps formulate the OCC's policy and supervisory responses to these risks. In that capacity, I am working with my OCC colleagues to improve the OCC's risk oversight practices and with my fellow supervisors both domestically and internationally to strengthen our collaborative supervisory frameworks in the aftermath of the financial crisis. Before I get into the topic of this speech, supervision matters, let me set the table.

We are now three to four years beyond the financial crisis that has caused great economic and social distress for US institutions and individuals as well as trading partners around the globe. With time now providing some perspective, we can assess what caused the crisis and how to mitigate against a re-occurrence. Despite numerous studies, a consensus view has not yet emerged as to cause and effect. Several schools of thought have appeared, each convinced of their own rightness. Here is a layman's summary of those schools, excuse me if I exaggerate a bit for effect:

> School 1. Bad behavior by banks and their shadow bank counterparts, driven by misaligned bonus incentives, led to weak loan and security underwriting standards and predatory lending practices.
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> School 2. Government policies both subsidized and encouraged lax lending practices with the twin colossi of Fannie and Freddie leading the dive to the bottom that created the subprime lending bubble.
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> School 3: Rating agencies had flawed models and conflicts of interest which caused them to mis-rate tens of billions of subprime securitizations and their derivative CDOs.
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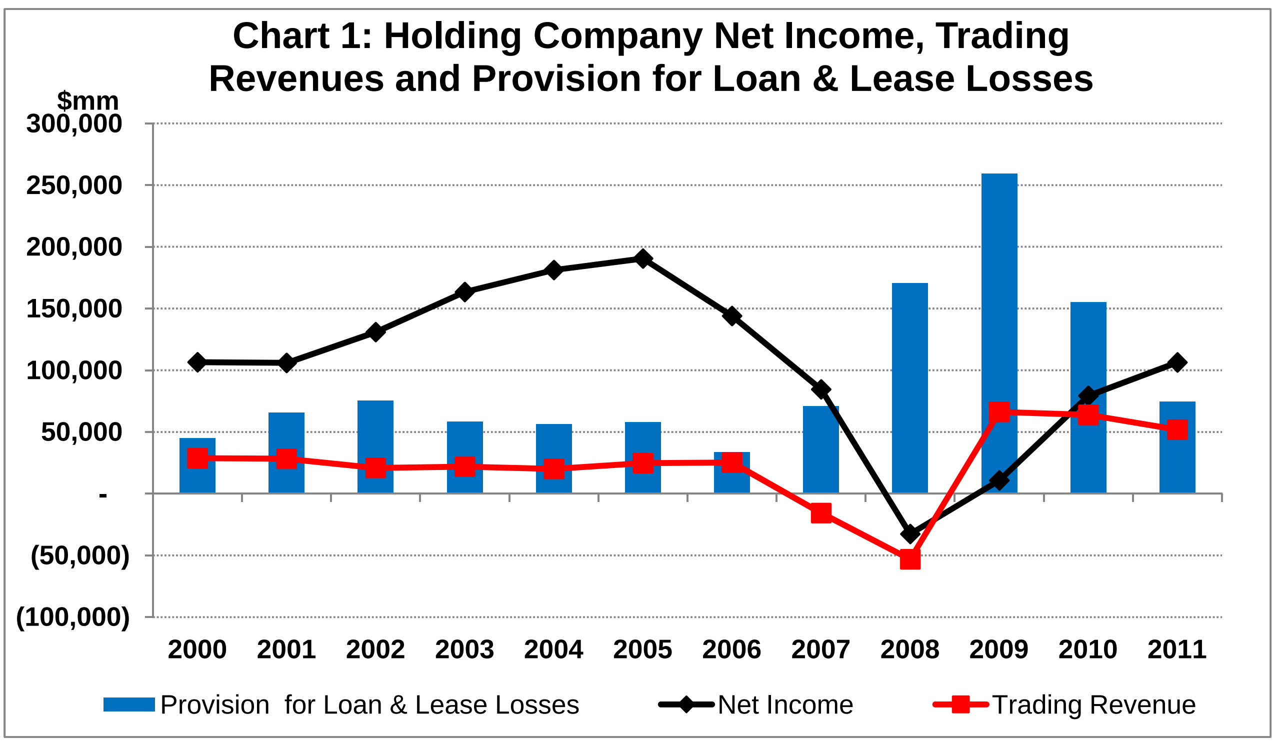
> School 4: Regulators were asleep at the switch and stood idly by while excessive liquidity and search for yield led banks, securities firms, specialty lenders, insurers, and other investors to take outsized risks. Supervision either lacked appropriate authority, was incompetent, or both.

My own view is that you don't make a mess this big without lots of contributors. Banks and shadow banks alike failed in properly assessing and underwriting risks across both mortgage and non-mortgage products. Incentives were overly misaligned toward short-term profits. Government policies, well intentioned as they were, subsidized and encouraged some of the overheating that led to the housing bubble. Rating agencies had become overly reliant on securitization fees which may have, in part, contributed to their failure to more quickly correct fundamentally flawed credit models. Finally, regulators such as my own agency could have done more in exercising the powers that were available to rein in the riskiest behaviors.

My focus today is on this last topic, supervisory oversight. As the OCC and other supervisors implement an array of legislative and regulatory responses designed to correct some of the identified shortcoming and gaps, it is also an opportune time to consider the role of traditional bank supervision—that is the core functions that OCC examiners conduct day in and day out through their on-site examinations at the more than 2,000 national banks and federal savings associations that the OCC supervises? What lessons have we learned and how do we intend to apply those lessons to shore up weaknesses in our risk management processes for identifying and responding to systemic threats? I'll touch more on that later.

First, let us focus on some of the lessons learned from the most recent financial turmoil. I will limit my comments to those areas with which I am familiar, namely, the performance of banks, and primarily nationally chartered banks. The chart shown illustrates the severe drop in national bank holding company profitability from 2007 to 2011. There were two drivers of this decline: credit losses and declines in trading revenue. The overwhelming drivers were traditional credit losses. This was a traditional credit cycle bust, albeit one that went beyond commercial real estate or C&I loans, and was dominated by the largest consumer loan asset class, residential mortgages. Provisions for credit losses increased from an average of $56 billion annually in the seven years leading into the crisis from 2000 to 2006, to $146 billion annually in the five years following the onset of the crisis. Despite the significant declines in 2007 and 2008, trading revenues averaged slightly higher in the five years following the crisis, $22.8 billion versus $21.1 billion.



Weak underwriting practices and increased risk layering in subprime and even prime assets, combined with investors across the globe searching for yield, helped fuel the housing bubble that has underpinned this latest credit cycle.

Regulators cannot reasonably be expected to eliminate credit cycles. We can, and should be expected to influence the severity of a cycle and the effect on bank safety and soundness.

The OCC has multiple tools that are available to take corrective actions when we conclude that systemic risk has exceeded safe thresholds or because we see unsafe and unsound practices within a supervised bank. These include citing Matters Requiring Attention in our Reports of Examination. MRAs put management and boards of directors on notice of specific deficiencies in a bank's practices that need to be corrected. If we do not see appropriate actions to address the MRAs, enforcement actions can be imposed. These include cease and desist orders, fines and penalties, and increased capital requirements. Besides individual actions targeted at specific banks and individuals, we issue supervisory guidance to alert both our examiners and the industry to heightened concerns around systemic risks and prescribe timely supervisory responses. Senior management often speaks at industry conferences to draw attention to policy views as well as risks. Tom Curry, confirmed as Comptroller of the Currency on April 9, has already given speeches addressing the state of the industry, enforcement and compliance, mortgage lending, and operational risks.

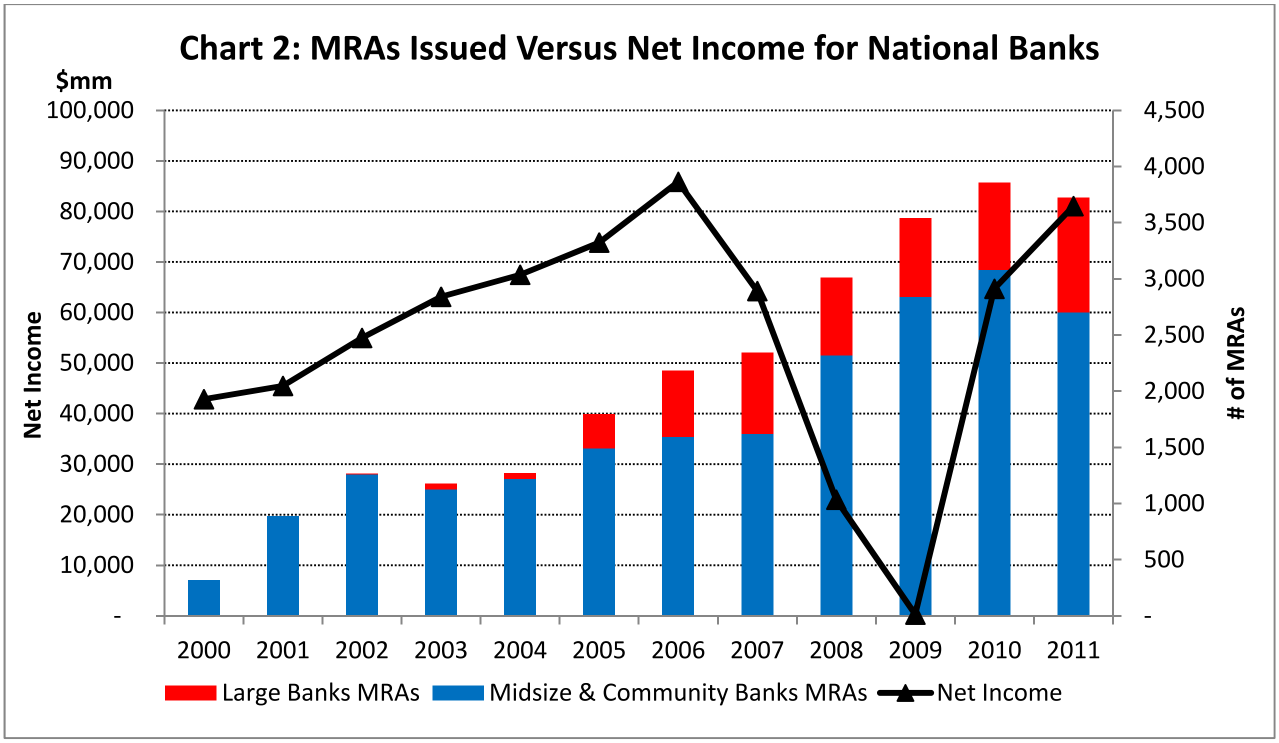
Outreach in the form of speeches and guidance is important but will not alone prevent the creation of an asset bubble. Nor, quite frankly, could the actions of any one regulator given the breadth of government, shadow banking, rating agency, and other players involved in the creation of the housing bubble. Still, action was required.

What actions were taken and how effective were they? Let’s focus on the supervisory actions taken by the OCC leading up to and during the crisis.

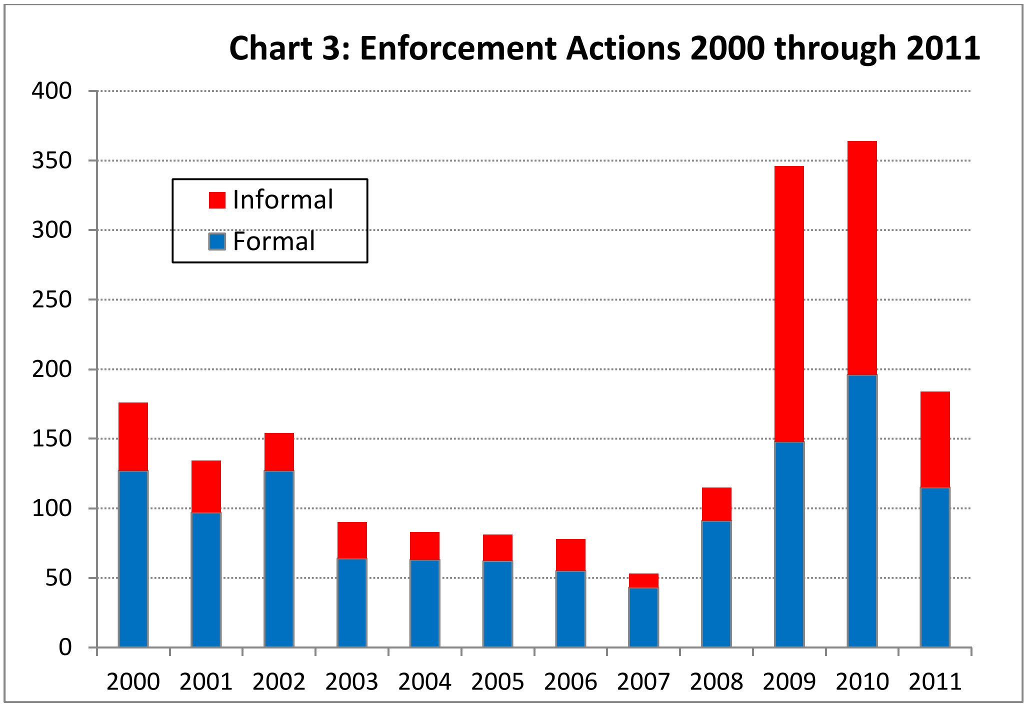
As I noted earlier, our examiners are often among the first to spot troubling trends and weaknesses, both at individual banks, which typically leads to MRAs, and across the system, which often is the catalyst for supervisory guidance and messages. For example in early 2001, in response to findings we were hearing from examiners, we issued more prescriptive inter-agency guidance on increasing capital charges related to sub-prime loans by 150 to 300 percent depending on the nature of that activity. The guidance was also more detailed in describing the characteristics of sub-prime lending programs to support implementation of the capital recommendations.

In 2004, we initiated the first of a series of targeted examinations at banks that we believed were at significant risk due to the nature and scope of their commercial real estate activities. Findings from these initial examinations, and the weaknesses we discovered in various risk management practices, helped to formulate the guidance that we and the other federal banking agencies proposed and then issued in final form in 2006 on sound risk management practices for concentrations in CRE lending. Likewise, the increased risk-layering that our retail credit experts were observing in the broader mortgage market prompted us to issue warnings to the national banks we supervised about abusive mortgage practices and to lead efforts to develop the interagency guidelines on nontraditional mortgage products in the latter part of 2005 and 2006. These actions were one reason why the much of the most troublesome types of mortgage loans, including much of the subprime and loans with negative amortization features, was done outside of the national bank charter. Yet as we have seen, to be fully effective, a broader regulatory response that would apply to all lenders, was clearly needed. This lesson has reinforced our commitment to seek interagency collaboration to identify and address issues that cut across the industry. It has also reinforced the importance of identifying potential problems and addressing them at an early stage through appropriate supervisory actions. Helping our examiners to be alert to trends and warning signs, and providing them with the policy and analytical support they need to direct banks to take corrective action is one of the primary functions of the OCC's National Risk Committee and the staff that I oversee.

Typically, MRAs are our first and most frequent type of supervisory action that we take to effect corrective action at banks. The chart shown reflects the trend in MRAs issued by the OCC in the five years preceding the crisis, 2003 to 2008, juxtaposed against the trend in industry net income. As you can see, we more than doubled MRAs during this period of overheating, with the largest growth attributed to large banks.



When an MRA is insufficient or inappropriate for obtaining corrective measures, we take enforcement actions. Because we typically try to resolve problems at the earliest stage and through our ongoing supervisory processes, the level and trends for enforcement actions generally lags MRAs, and this was the case during this last cycle. In retrospect, there were instances where we should intervened with various enforcement actions at an earlier stage and we are evaluating those experiences to determine how we can better calibrate our supervisory response to ensure prompt correction when examiners identify problems.



Before turning to how the OCC is addressing weaknesses, I'd like to discuss some areas where there appear to be positive supervisory impacts on bank performance. In September of last year, the OIG issued a report on Prompt Regulatory Action that showed substantially lower losses to the Deposit Insurance Fund for nationally chartered banks. This was driven by two factors—a 17 percent lower probability of default and approximately 50 percent lower losses incurred for those institutions that did default.

It is challenging to attribute specific differences in supervision as drivers of these variances. No such control models exist. Geographic distribution, management practices, and the degree of direct government support in the form of TARP and various liquidity support facilities all played a role. As we look at smaller institutions which comprise 95 percent of the banks supervised by the OCC, we see a couple of obvious factors that are influenced by supervisory practices:

1. Denovo banks, those less than five years old, fail at three to four times the rate of more mature banks. There are significantly fewer numbers of denovo banks that are nationally chartered due, in part, to the higher costs associated with a national charter and the

perception by some that the OCC imposes a higher standard of supervision.

2. Charter flips fail at 50-to-80 percent higher than the rate of banks that retain the same charter over time. From 2000 thru 2010, 113 banks switched away from a national charter while 12 banks switched to a national charter. Let me be clear, the OCC supports our dual state/federal oversight system and we recognize there are valid reasons why a bank may elect to switch charters. However, avoiding supervisory corrective actions is not one. To prevent such actions, in 2009, the federal and state banking agencies under the auspices of the Federal Financial Institutions Examination Council issues a statement on regulatory conversions to reaffirm our collective position that supervisors will only consider applications undertaken for legitimate reasons and will not entertain regulatory conversion applications that undermine the supervisory process. Section 612 of the Dodd-Frank Act codifies and strengthens this basic tenet and the OCC is leading an interagency group to incorporate these provisions into the agencies' processes.

3. The aggressive rate at which we issued MRAs beginning in 2003 may also have had sufficient corrective action to influence bank behavior during this time period. Only 25 percent of our MRAs were repeat MRAs, which indicates that bank management took necessary corrective action on 75 percent of the identified deficiencies.

At the OCC, we believe supervision matters. We clearly should have done more leading into the crisis that could have had some mitigating effect on outcomes. But we also believe the relative performance evidenced by nationally chartered banks was likely influenced by supervision practices. What are we doing going forward to redress identified weaknesses and maintain investment in areas of strength?

Above and beyond the significant impacts of implementing Dodd Frank and various Basel initiatives, the OCC has taken the following actions to bolster our policy and supervisory practices to optimize the safety and soundness of nationally chartered banks:

1. Established heightened standards around risk management practices and governance for our largest institutions. Importantly, at the largest national banks, we have made it clear that risk management controls and systems need substantial strengthening and

merely “satisfactory” systems are no longer sufficient. We also are stressing the importance of strong board oversight and corporate governance at banks of all sizes. Key to this is a board that has the stature and sufficient information to pose credible challenge to bank management and to those of you in this room that are risk managers. I will advise you that one red flag we warn directors about are risk managers who respond to a query that “it’s complicated.” Our message to the boards is if you don’t understand, you should ask, and if a risk or activity cannot be explained in terms you can understand, your bank should probably not do it.

2. Improved transparency through publication of a *Semi-Annual Perspective on Risk* by our National Risk Committee. This will publicly communicate our views on threats to the industry. It will also communicate our views to what we refer to as “analysts with aligned interests.” Credit rating agencies, fixed income, and equity analysts all have a stake in safety and soundness of the banking sector. As you well know, the views of an equity or credit analyst on a bank's performance can have a substantial impact on its funding and capital costs. Our report, a copy of which will be available on OCC’s Web site, will convey the OCC's National Risk Committee view of systemic threats, the empirical data that supports that view, as well as what are we doing about those threats. Look for a press release in the next two weeks that will have an imbedded link to the report. We would welcome your feedback.

3. Improved interagency coordination through the Financial Stability Oversight Committee as well as through sharing supervisory information with other federal financial regulators and the CFPB. We are increasingly coordinating with our fellow regulators on the assessment of systemic threats such as the Eurozone crisis and new tools to aid oversight. An example of the latter are are enhanced liquidity templates, a more granular reporting requirement introduced by the Federal Reserve Bank of New York and supported by the OCC and the FDIC. It is an example of enhanced supervisory practices with benefits for large, complex banks as well as for those of us responsible for regulatory oversight. Liquidity has always been a key driver of solvency during times of stress. Enhanced reporting will provide banks and their regulators a common set of data

for monitoring early warning indicators of liquidity stress.

4. Continued use of MRAs and enforcement actions where appropriate to ensure deficiencies in bank practices are corrected. The Mortgage Foreclosure Consent Order is one example affecting a large segment of servicers, but we have also taken actions to address a broad array of supervisory concerns.

5. Maintenance of our standards around both denovo banks and charter flips. We continue to believe that a national charter holds material value, that strong supervision should not be disparaged, and that the benefits derived from strong supervision generate a high return on investment for those institutions that qualify for the national charter.

Prior to closing, I offered to provide some insight into what are the key risk concerns currently being monitored by the OCC's National Risk Committee and acted upon by our supervisors. As I mentioned at the outset, the NRC is a cross-functional group that brings together our senior staff from our line supervision, economics, legal, and policy areas. The NRC meets quarterly to review macro and micro economic trends, issues identified by our examiner network groups, and issues identified by our risk management groups within each line of business. It is a bottom-up approach to risk management, leveraging the insights we gain from our field examiners.

Our last NRC meeting was in late April and the following themes emerged:

1. The after effects of the housing bubble continue to weigh heavily on economic growth and pose ongoing credit, operational, and reputational challenges for banks. It does not appear that we have yet hit bottom in the pricing of housing stock in many regional markets and the issues attendant to resolution of foreclosure processing have delayed market clearing from occurring more quickly. At the OCC, we are focused on completing the consent order process around mortgage foreclosures as efficiently and effectively as possible. This will both allow banks to proceed with modification or foreclosure actions that are economically viable as well as ensure that mortgage servicing standards going forward are safe and sound.

2. Smaller institutions continue to have high concentrations of loans to Commercial Real Estate, a sector that has benefitted from low rate refinancing opportunities but continues to experience weak net operating income due to lack of robust growth in employment. Any rate rise or further weakness in employment would increase risk of loss from this asset class. We continue to monitor portfolio performance at our banks and the level of allowance for loan losses that support these assets.

3. An historically low rate environment poses several challenges. It is putting pressure on net interest margins, particularly as low loan demand forces banks to purchase lower yielding securities to bolster asset returns. It also increases risks to a sudden spike in rates, as securities portfolios contain longer duration or more convex securities. Our examiners will be focusing on outlier institutions, i.e. those with higher concentrations of longer term fixed rate assets. From a policy perspective, we recently issued interagency guidance on interest rate risks and will continue to highlight this issue in future supervisory memos to our field as well as ongoing integration calls with thrifts.

4. Finally, banks are seeking returns on the increases in both equity and liquidity that they have raised under pressure from regulators and markets alike. Fee income is down as is loan demand, creating competitive pressures to lower underwriting standards, price or both. We are seeing that trend in high yield, cards, and commercial and industrial loans at present. While we are not unduly alarmed at this time as volumes remain relatively low by historical standards, however the trend will be worth monitoring closely. Our examiners will be turning more of their attention to new product risks and spending less time on evaluation of legacy assets.

The good news for U.S. institutions is that common equity capital and liquidity are at or approaching historical highs. As are loan loss reserves despite recent reductions in provisioning. That balance sheet strength provides an ample cushion against tail events such as we experienced in 2007 through 2009. The recent CCAR stress tests demonstrated that institutions have the capacity to withstand a severe economic and market based shock.

In closing, while headlines will continue to focus on the give and take around rules and regulations, the OCC remains focused on ensuring that supervision is effective and efficient. As we approach our 150th anniversary in 2013, we remain committed to practices that advance the safety and soundness of nationally chartered banks and the banking system as a whole. Our National Risk Committee will remain vigilant in monitoring risks and the banking system appears well capitalized to deal with the challenges of an evolving business model. Thank you for your time and attention.