

**Remarks by
John C. Dugan
Comptroller of the Currency
Before the
OCC Compliance Conference**

July 7, 2008

“The Need to Stay Focused on Compliance Supervision”

I'm delighted to be here today to talk about the OCC's commitment to compliance supervision. I've had an opportunity to look over the conference program, which is very impressive – I'm sure it will provide you with important insights over the next three days.

When I last addressed this conference nearly three years ago, I had been in office just over a month. In fact, this conference provided the forum for my very first speech as Comptroller of the Currency, something that I thought was very appropriate. You may remember that I faced quite a grilling at my confirmation hearing on one particular compliance issue, Bank Secrecy Act enforcement. I told the Senate Banking Committee that one of my earliest priorities as Comptroller would be to strike the right balance to ensure that banks have effective BSA programs, but without imposing undue regulatory burden.

This was an issue that I devoted a great deal of time to in my first year in office, and I was pleased to find that the OCC had an exceptionally talented staff to help me work through it, which is just what we did. Because of that and other efforts, I think we have made great strides towards striking that elusive BSA balance, and I'll have more to say about that later.

Looking back today to my first months on the job, it's hard to believe how much the world of banking has changed. Three years ago, the industry was enjoying record profits. Capital was high, loan losses were low, and the outside world was much more interested in our compliance efforts than our safety and soundness work. Today, by contrast, national banks face significant credit and liquidity challenges. And when I talk to reporters, they are much more likely to ask me whether our banks can raise enough capital than whether they have effective BSA programs.

All true, but my fundamental message to you today is this: we simply cannot take our eyes off compliance while we address safety and soundness. We know how to deal with credit issues, and we will work our way through these very difficult problems. What I don't want, though, is to finish dealing with the industry's safety and soundness issues only to find that we've allowed significant compliance problems to develop in their place.

I say that, first of all, because compliance supervision addresses issues that are vitally important. The Bank Secrecy Act, for example, began as a means of combating illegal drugs and grew into a major weapon in the war on terror. The flooding in Iowa provides dramatic evidence of the importance of flood insurance programs. The fair lending laws help ensure that borrowers are not the victims of unlawful discrimination. Community reinvestment has visibly transformed neighborhoods around the country. And the broad range of consumer protection laws applicable to banks is designed to safeguard important interests of bank customers. I could go on, but I think the point is clear. The work you do serves important national interests.

Compliance supervision is also closely related to the industry's safety and soundness. We saw in the case of Riggs that compliance lapses can threaten the

existence of a large and storied bank. That's admittedly a rare situation, but it's not so rare to see that a bank's failure to comply with important laws and regulations can lead to significant damage to its reputation – the kind of damage that can take years to repair and that diverts management time and attention away from the business of running the bank.

And compliance problems drain management time and bank resources in a number of other ways. Compliance failures can lead to lawsuits, civil money penalties, and restitution settlements for customers damaged by unfair practices. The bank's stock price may suffer, and senior executives may choose to leave rather than stay at an institution with a damaged reputation. And of course, customers can flee.

That's bad enough during good economic times. But it's far worse in times of stress, when bank management is likely to have its hands full dealing with credit and liquidity issues. When a bank is trying to raise the capital it needs to survive, the last thing management wants is to be tagged with charges of unfair or deceptive practices or a fair lending problem.

My point is this: If we continue to do a good, consistent job with our compliance supervision, then as the economy turns down and banks across the board are dealing with credit problems, they should be much less likely to make the kinds of compliance mistakes that harm consumers and distract bankers from their other significant challenges.

Of course, to do that good job, we have to have the right people, and I believe we do – meaning all of you. In my three years as Comptroller, I've worked closely with [Ann Jaedicke](#) and her staff, and I've had occasion to talk about compliance issues with many

of you. I can say with conviction that compliance supervision at the OCC is in very good hands.

Now, since we are in midst of a downturn, I'm sure the question many of you are asking is, what happens to compliance supervision? Will compliance work be ignored as we increase our focus on the increased risks to safety and soundness? The answer is no – for all the reasons I've just mentioned, we simply can't afford to put compliance supervision on hold. As safety and soundness issues come to the fore, it is imperative that we guard against compliance complacency.

But having said that, I also want to emphasize our agency credo of risk-based supervision. When risk increases in one area, we do change our emphasis and shift more of our resources to address the heightened risk. That's what we did when the BSA compliance risk increased, and that's what we will do as safety and soundness risk continues to rise. That does not mean that compliance supervision will take a back seat. But it does mean that there will be times when some of you who spend most of your time on compliance will be asked to help out on safety and soundness. The agency's flexibility to pull together as a team to address challenges as they arise – without compromising other core responsibilities – is one of our great strengths. But we will obviously need to work hard on an ongoing basis to make this balancing of priorities work the way it should.

Let me turn now to some compliance issues that are likely to come to the fore in the coming year. As I do so, I think it's important to keep the election in mind, both for a new Administration and a new Congress. I think it's fair to say that the current Congress has been more focused on compliance issues – especially consumer protection issues –

than previous Congresses. I see that trend continuing, regardless of the outcome of the Presidential election, and even if credit and safety and soundness issues become more pronounced.

Fair Lending

One priority compliance issue in the next year will be fair lending. As I said before, fair lending laws address the fundamental issue of preventing unlawful lending discrimination. There will continue to be close scrutiny of the way that banks make loans, especially in light of the subprime problem.

I am pleased to say that the OCC has had in place for quite some time a comprehensive supervision program to address fair lending compliance. In addition to the substantial work that our examiners do in this area, the Risk Analysis Division in Economics has provided critical, cutting edge support in the type of statistical analysis that is often critical to fair lending compliance at our larger institutions. Our process is rigorous, as it needs to be for the often complex analysis required to conduct a meaningful fair lending exam.

Now, while I am pleased that we have this comprehensive process in place, I have to say that we don't always explain what we do and how we do it as well as we should. In fact, [Tim Long](#) and I have thoroughly discussed this issue and have agreed that one of his priorities in the coming year will be to address this issue through improved documentation and communications regarding our process. Transparency is important in and of itself, but also because it helps bring discipline to any process and helps identify areas that need improvement.

I should add that we have not seen major fair lending problems in the national banking system during my tenure as Comptroller, and that is very much a good thing. But of course we need to remain vigilant, and one area that bears watching is loan workouts. In the past, fair lending exams have focused particularly on who received loans and who didn't, and on the pricing of those loans. These remain very important concerns. But in today's difficult economy, with so many mortgages having problems, banks also need to be sure that similarly situated borrowers who default or become delinquent are treated similarly, with no variations based on prohibited factors like race or gender. For example, it's important that borrowers aren't being foreclosed on more quickly or denied access to modification programs because of their race. This is in many ways a new area, because most banks have never had to run foreclosure and workout programs on so large a scale, and we will need to adjust our practices accordingly.

Consumer Compliance Issues

As I mentioned before, consumer protection issues should continue to receive a considerable amount of congressional attention in the coming year. It's difficult to predict whether that will result in legislation, but I do think that the Federal Reserve could very well issue significant new final rules regarding subprime mortgages and credit cards. The proposed rules addressing each of these areas represent a significant change in approach, especially in the area of unfair and deceptive practices, where there is a pronounced shift away from disclosure-focused regulation towards rules that are considerably more prescriptive. If adopted in anything like their current form, these regulations will precipitate a significant shift in focus for our examiners as well. So it will be important to track closely developments in this area.

Subprime Lending and CRA

Another area of focus in the coming year may well be CRA, especially as it relates to subprime loans. Some banks stretched underwriting standards to make subprime loans that qualified for CRA credit, but even more lenders – most of them outside the commercial banking industry – stretched standards even further in a quest for quick profits.

One concern I have is that some lenders may have concluded from the subprime crisis that they should retreat once and for all from the subprime market. That would be more than unfortunate. There's no reason why lenders can't make loans to low-income borrowers in a safe and sound manner. Instead, CRA encourages banks to make loans to creditworthy borrowers in low-income communities, and that is what we should expect of national banks. There are ways for banks to make good loans that will fulfill their CRA obligations.

Having said that, we need to recognize that we're in a new environment, and that CRA loan volume may be lower than in previous years. In part, that probably reflects a return to more prudent underwriting standards. While CRA does not ask banks to make unsafe loans, in the more freewheeling environment of the past several years, some subprime loans were made that should not have been made, and were then counted for CRA purposes.

In short, I expect you'll be seeing some new wrinkles when you perform CRA exams this year and next – smaller portfolios, perhaps, and new types of products – and you should evaluate them in a fair and balanced way.

Bank Secrecy Act

Finally, let me briefly return to compliance with the Bank Secrecy Act and other anti-money laundering laws. While not so much in the news anymore, this issue hasn't lost any of its importance. As I mentioned at the outset, the OCC was devoting a tremendous amount of time and resources to BSA compliance when I arrived, and we've built on that work ever since.

One measure is the substantial increase in the amount of examiner time devoted to BSA compliance. That time doubled between 2003 and 2004, and it doubled again the following year. Since then, it's drifted down a bit, but that slight reduction reflects the very significant improvement in bank BSA programs.

Of course, while some were arguing that the OCC wasn't as vigilant as it should have been in BSA compliance, many others – mostly in the banking industry – argued that all of the regulators were spending too much time on BSA. I think there was some truth to both points.

Clearly, our BSA enforcement in the past wasn't as effective as it should have been, and it had to be fixed. The challenge, though, was to fix BSA compliance supervision without needless increases in regulatory burden. I think we have made great strides to meet that challenge.

Why do I say that? I think it's a combination of factors. One is that, by raising the bar through greater focus on BSA supervision, we addressed in a thoughtful way the enhanced focus that Congress demanded. A second is that banks, after complaining loudly about the precipitous raising of that bar and uneven supervision, have come to a much better understanding of what is expected of them through the widespread

implementation of the interagency manual. I receive far fewer complaints than I once did about BSA supervision getting ever more onerous or being inconsistent. I think we have demonstrated to our bankers that the bar, once raised, is not getting higher. And I think they've gotten used to the consistent level of supervision that we now conduct. That's not to say they like it or think it shouldn't be reduced, but the nature and intensity of complaints has clearly declined, and so has the decibel level of the discussion surrounding BSA compliance.

Conclusion

In compliance, as with almost every area of supervision, the OCC is able to bring a variety of resources to bear in support of the mission. A good example here is our Economics department, which works closely with you to identify mortgage portfolios that may have higher potential for fair lending problems. Irene Fang is here this week to talk with you about ways we can work together to improve our fair lending screens and processes. And Economics is sponsoring a fair lending seminar later this year in New Orleans, where we hope to bring together people from many different disciplines to talk about fair lending issues.

The Ombudsman's office is another area of support for our compliance mission. [Larry Hattix](#) is in the audience and I'd like to recognize him. I know he's going to speak at this conference, and that's very appropriate because he will be playing an important compliance role. Indeed, the complaint data that comes from the Customer Assistance Group is one important indicator you can use to spot consumer compliance problems. So I would expect that you will find yourself working very closely with Larry and his staff in the coming years.

Finally, I think it's worth reminding ourselves that the OCC is subject to reputation risk every bit as much as a bank. Our reputation, and our standing as a regulator, suffered greatly because of the lapses in our BSA supervision. We don't ever want to be in that position again. What worries me in this regard is that we might fall victim to our own successes. When things go well for a prolonged period of time, it's easy to believe they will continue to go well. Consciously or not, it's easy to develop compliance complacency, and that's when we can get into trouble.

So let me repeat what I said at the outset. Compliance supervision is important. It's important to bank customers, and it's important to our national security. It's important for the safety and soundness of the banks we supervise, and it's important to the OCC's standing as a bank regulator. We need to give compliance our very best efforts. I look forward to working with all of you to do just that.

Thank you very much, and enjoy the 2008 OCC Compliance Conference.