

David K. Wilson
Senior Deputy Comptroller and Chief National Bank Examiner
Office of the Comptroller of the Currency
before the
Subcommittee on Oversight and Investigations
Committee on Financial Services
U.S. House of Representatives
July 27, 2011

Chairman Neugebauer, Ranking Member Capuano, and members of the Subcommittee, I appreciate the opportunity to testify about the initiatives the OCC has undertaken, and the challenges we are facing, in our work to implement section 939A of the Dodd-Frank Act.

Section 939A requires each federal agency to review its regulations that refer to, or require the use of, credit ratings in connection with an assessment of the creditworthiness of a security or money market instrument. Each agency must then modify its regulations to remove any reference to, or requirement for, reliance on credit ratings and to substitute alternative standards of creditworthiness that the agency determines are appropriate. Section 939A also requires each agency to transmit a report to Congress; the OCC will be submitting its report today.

OCC regulations affected by this provision include the interagency risk-based capital regulations and OCC-specific regulations pertaining to national bank investment securities activities, securities offerings, and international banking activities.

The banking agencies' risk-based capital standards use credit ratings to determine appropriate capital requirements and assign risk weights to securitizations and exposures to qualifying securities firms. Credit ratings are also used to assign risk add-ons under

the agencies' market risk rule and to determine the eligibility of certain guarantors and collateral for credit risk mitigation purposes. Section 939A could also significantly affect future implementation of other Basel Accord capital standards in the United States. These include the standardized approach for credit risk, which relies extensively on credit ratings to assign risk weights, as well as the 2009 revisions made by the Basel Committee to enhance and strengthen international risk-based capital standards.

The OCC's investment securities regulations use credit ratings for determining the credit quality, marketability, and appropriate concentration levels of investment securities purchased and held by national banks. Credit ratings are also referenced or used in our regulations governing securities offerings by national banks and the types of assets federal branches and agencies can hold as a capital equivalency deposit.

The OCC has issued two advance notices of proposed rulemaking to seek input on how to revise our regulations to implement section 939A. An interagency ANPR sought comment on several approaches for developing creditworthiness standards for the agencies' risk-based capital rules. These approaches varied in complexity and risk-sensitivity.

We issued a similar ANPR on alternative creditworthiness standards for our non-capital regulations.

The agencies also hosted a roundtable discussion, attended by bankers, academics, asset managers, credit rating agency staff, and others to discuss alternatives to credit ratings.

Commenters on the ANPRs and roundtable participants generally expressed concerns with the removal of credit ratings from our regulations and asserted that credit

ratings can be a valuable tool for assessing creditworthiness. Many commenters believed that the simple approaches outlined as an option would, due to their lack of risk-sensitivity, create incentives for inappropriate risk arbitrage. However, commenters were also concerned that more complex and risk-sensitive approaches would, due the depth and types of analyses that would be required, pose a disproportionate burden on small banks. Commenters also expressed concern that certain alternatives could create competitive inequities and inconsistencies with the international capital standards established by the Basel Committee.

These comments reflect the challenges that the OCC and other federal banking agencies are facing as we work to implement section 939A. We believe that with appropriate operational and due diligence requirements, credit ratings can be a valuable factor to consider when evaluating the creditworthiness of financial instruments. In our view, an approach that precludes undue or exclusive reliance on credit ratings – rather than imposing an absolute prohibition to their use – would strike an appropriate balance between the need to address the problems created by overreliance on credit ratings with the need to enact sound regulations that can be consistently implemented.

Notwithstanding these challenges, we are continuing our work to revise our regulations to be consistent with section 939A. We are being careful and thorough in order to ensure that the result is not a step backward in assuring that banks of all sizes conduct their activities in a safe and sound manner that reflects sound credit judgment and adequate capital for the risks they take.

Thank you. I would be happy to answer questions you may have.