STATEMENT OF

JOHN C. DUGAN
COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON FINANCIAL SERVICES

and the

COMMITTEE ON SMALL BUSINESS

U.S. HOUSE OF REPRESENTATIVES

February 26, 2010

Chairman Frank, Chairwoman Velázquez, and members of the Committees, I appreciate this opportunity to discuss the lending activities of national banks and the OCC's actions to maintain a supervisory climate that facilitates sound lending to consumers and businesses.

Access to credit is critical to the health of our nation's economy, and national banks play a vital role in meeting this need. The OCC has always encouraged national banks to lend to creditworthy borrowers. In fact, banks cannot be healthy and profitable if they do not continue to focus on making sound loans to businesses and consumers.

While there are signs that the economy is beginning to recover, significant stresses continue to restrain both the demand for credit and its supply. The result has been a sharp reduction in the outstanding loans of commercial banks of all sizes and across nearly all loan categories.

In terms of demand, businesses have sharply curtailed capital expenditures and reduced inventories, the typical drivers for commercial bank loans. Indeed, the recent cutbacks in fixed investment, inventories, and accounts receivable by U.S. nonfinancial companies is unprecedented in the past 55 years for which we have historical data. Consumers likewise have cut back on spending and are saving a larger share of their income.

The resulting reduction in loan demand has been pronounced, including for small businesses. Reports issued by the National Federation of Independent Business over the past two years have consistently shown that underlying business conditions, rather than access to credit, is the primary issue facing many small business owners.

Still, the decline in loans also reflects the reduced supply of credit. As the deteriorating economy has taken a toll on consumers and businesses, bankers have also become more cautious. Loan underwriting standards generally have tightened across the industry, reflecting in part a return to more prudent practices and in part becoming more conservative. These changes have resulted in higher down payments, additional collateral, and other requirements that have clearly affected the ability of some borrowers to obtain credit.

We recognize that this environment presents particular challenges to the OCC and the other banking regulators. It is imperative that we take a balanced and consistent supervisory approach to ensure that our actions do not discourage banks from making loans to creditworthy borrowers. Many have questioned whether the regulatory pendulum has swung too far, to the point where regulators and examiners are impeding banks' ability to make even prudent loans. This is a matter we take very seriously, and we have taken numerous steps throughout this credit cycle to ensure that examiners are taking a balanced, fair, and consistent approach across the country.

These actions have included interagency statements on commercial real estate loan workouts and small business lending, both of which clarify our expectations and underscore that examiners will not criticize banks for prudent lending activities. We have reinforced these messages through regular communications with our examination staff. For example, we have consistently instructed examiners <u>not</u> to tell bankers which loans to approve and which to deny, and <u>not</u> to criticize loans based simply on collateral values or a borrower's association with a particular industry or geographic location. Instead, we continue to stress that national banks should:

- Make sound loans to creditworthy borrowers;
- Work with borrowers who are facing difficulties; and
- Recognize and address problem credits by maintaining appropriate reserves and taking charge-offs when repayment is unlikely.

We also continue to work with Congress, the Administration, and the industry on programs that can provide additional assistance to the hardest hit sectors. We support a number of small business lending initiatives, and we have worked hard to help bankers understand and more fully use the various programs offered by the Small Business Administration.

Finally, let me offer one cautionary note. While we should be very careful not to encourage the banks we supervise to become excessively conservative, we simply cannot turn a blind eye to increasing losses and mounting credit problems. 185 banks have failed since the start of the crisis, including 33 national banks; estimated losses to the FDIC exceed $57 billion; and we are likely to have even more failures in 2010 than the 140 we had last year.

In this environment, we need to avoid the kind of forbearance that put off problems and caused such huge losses in the savings and loan crisis, an experience that led Congress to enact the Prompt Corrective Action regulatory regime in 1991. That regime reinforced to supervisors how important it is for institutions to realistically recognize losses and deal with them – both to avoid further problems and, more important, to put themselves in a better position going forward to make loans to creditworthy borrowers.

Thank you.