Remarks by FDIC Chairman Jelena McWilliams, ‘From Principles to Practice: Improving and Modernizing Bank Supervision,’ Federal Reserve Board Conference on a “Bank Supervision: Past, Present, and Future”

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Good afternoon and thank you, Howell Jackson, for that kind introduction. Thank you also to Vice Chairman Quarles and other members of the Federal Reserve Board for hosting this conference on the ever-important topic of bank supervision. I appreciate the opportunity to speak with you today and to appear alongside many esteemed colleagues and friends.

Nearly two years ago, I outlined several principles that should underlie our approach to supervision: transparency, certainty, consistency, diligence, and communication, among others.[1] Fundamentally, supervision seeks to ensure that banks are operating in a safe and sound manner and meeting obligations under consumer protection laws.[2] A supervisory program characterized by clear rules, consistent application, holistic evaluation, and two-way dialogue will result in a safer banking system.

Over the past two years, we have taken several meaningful steps to improve our supervisory program in furtherance of these principles. Today, I would like to discuss a few key actions and explain how they support our near-term objectives. In addition, I will describe our longer-term project of supervision modernization and offer a few thoughts about the future of bank supervision.

Improving Bank Supervision

Transparency

With the goal of increasing the transparency of our supervisory programs, my first major initiative as Chairman was "Trust through Transparency," which seeks to foster a deeper culture of openness across the agency.[3] As part of this effort, we began publishing performance metrics, including turnaround times for examinations and bank charter applications, as well as data on the status of supervisory and assessment appeals.[4]

While transparency is a critical first step, it is not the ultimate goal. Rather, the heightened public accountability that follows our quantitative disclosures is intended to result in quicker turnaround times and clearer standards for examinations, applications, and appeals. And there has been evidence of tangible and measurable progress in this regard.

For example, during the 12-month period that ended October 31, 2020 – which included more than seven months of mandatory telework for all FDIC employees and most supervised institutions – nearly 85 percent of safety and soundness examinations were conducted within our

75-day goal and nearly 98 percent of consumer compliance and Community Reinvestment Act examinations were conducted within our 120-day goal.[5] Similarly, examination report processing time (i.e., the time from when field work is complete to when the report is sent to the bank) has significantly improved.

But transparency must go beyond numbers. We have also taken steps to ensure that the legal framework underlying our supervision is transparent. For example, last year we began a comprehensive review of our longstanding regulatory approach to brokered deposits.[6] One key objective of this rulemaking process is to develop a framework that is more clearly defined and consistently applied – giving supervised institutions a better understanding of decisions that had previously been made behind closed doors. This framework, in turn, will increase accountability and improve supervision. Next week, the FDIC Board will consider a rule to finalize these changes.

Certainty and Consistency

As we increase the openness and transparency of the agency, we have also clarified the standards governing examinations and applications so that supervised institutions understand the criteria against which they are being evaluated.

As just one example, to enhance the certainty and consistency of our supervision and examination program, the FDIC and several other federal regulators issued a statement in September 2018 clarifying that examiners will not criticize an institution for a "violation" of supervisory guidance, but only for violations of law, regulation, or non-compliance with enforcement orders or other enforceable conditions.[7] Earlier this year, we issued a proposed rule that would generally codify the statement and clarify that it is binding on each agency.[8]

We know from supervisory experience and communication with supervised institutions that guidance can play an important role in providing clarity. However, we also recognize that, unlike a law or regulation, guidance is not an appropriate basis on which to take enforcement action.

Communication

Perhaps the most important component of an effective supervisory program is open, two-way dialogue between supervisors and institutions. Simply put, institutions should not be surprised by findings in examination reports because open communication over time with their supervisory agency should notify them of potential issues. Not only does free-flowing communication result in a fairer process, but it also facilitates better compliance through collaboration.

We have worked toward this goal in several ways, perhaps most importantly through interactions among examiners, case managers, our Regional Directors, and FDIC-supervised institutions. And we have also increased collaboration through webinars, workshops, roundtables, and technical assistance videos that convey our supervisory expectations. We have worked hard to improve the quality and clarity of our communications with stakeholders, by using clearer language and less jargon.

Collaboration does not mean that there will always be an agreement between a regulated entity and its regulator. But if we are operating from a position of shared understanding, then our ability to work with institutions to mitigate risk before it grows – or to provide guidance as banks consider new technology, products, or services – is greatly enhanced.

In instances where there is disagreement in the context of an examination, we are undertaking a process to improve our process for supervisory appeals. With the objective of enhancing fairness and independence, we issued a proposal earlier this year that would replace our Supervisory Appeals Review Committee with a new Office of Supervisory Appeals – a standalone unit within the FDIC with final authority to resolve appeals.[9]

The FDIC would recruit external candidates to staff the Office, focusing on individuals with direct experience with the examination process – such as retired bank examiners – who would likely serve staggered, time-limited, nonpermanent terms.

We received several thoughtful comments on the proposal, which we continue to review as we seek to finalize it in the near future.

Modernizing Supervision

At the same time that we have explored ways to improve bank supervision in the near-term, the FDIC continues to focus on the longer-term project of modernizing supervision. In part, this effort seeks to leverage technology to reduce the amount of time that examination teams spend on-site at supervised institutions, which contributes to the quicker examination turnaround and report processing times I discussed earlier.

Yet, it ultimately seeks to achieve a more fundamental policy objective: changing the very nature of supervision and examination from static, point-in-time assessments to more routine engagement and analysis, all at lower cost for the FDIC and institutions.

COVID-19 Response

Our ability to transition to an exclusively remote examination environment during the COVID-19 pandemic illustrates the benefits of a technology-driven approach to supervision. Remote examinations have leveraged collaboration technology and file-sharing tools, and the majority of institutions have had no difficulty with the FDIC continuing examinations.

This move to 100 percent off-site examinations did not come without some costs:

- It eliminated the face-to-face communications with banks and their staffs that are such an important element of our examinations – and will continue to be in the future once the pandemic ends;
- It highlighted gaps in the FDIC's technology for conducting and managing remote examinations; and
- It has focused my attention again on the very disparate state of technology adoption across the 3,200 banks that the FDIC supervises, particularly community banks.

The Road Ahead

Where do we go from here?

With sustained focus and targeted investments, the FDIC can dramatically change how we conduct supervision, utilize technology to detect risk at institutions and system-wide, and engage with institutions to mitigate risks to safety and soundness and ensure consumer protection. These changes have the ability to both increase the efficiency and effectiveness of examinations and decrease the cost of compliance for supervised institutions.

Last year, we established a new Subcommittee on Supervision Modernization, which reports to our Advisory Committee on Community Banking (CBAC), to make recommendations for improving our approach to supervision.[10] The Subcommittee – which is comprised of bankers, former regulators, educators, and technology industry experts from a range of fields – held a number of meetings and engaged in small-group discussion with agency staff, and these discussions illuminated a number of areas where progress could be made, both within the FDIC and across the industry. The Subcommittee also made one point very clear: if this supervision transformation was simply a cost to industry, without corresponding benefits, it would ultimately fail.

The FDIC's task is really quite simple:

- Foster a technological transformation in the industry we oversee, promoting a safe, dynamic, technology-driven marketplace for financial services;
- Develop a more dynamic supervision model that improves FDIC effectiveness and promotes financial stability; and
- Do it all in a manner that reduces unnecessary regulatory burden and cuts compliance costs for banks.

Obviously, we are not going to fundamentally transform the industry and the FDIC during the remainder of my tenure as Chairman, but we are going to tackle these challenges with urgency, and we are going to lay the foundation for the future of banking.

First, we are going to remove unnecessary regulatory impediments and operational uncertainty associated with adopting new technology at FDIC-supervised banks. This begins with streamlining the way community banks partner with third-party technology providers and how they can use technology.

We are off to a good start: issuing guidance on bank partnerships with fintechs and interagency guidance on use of alternative data in underwriting. We also proposed a new public/private partnership that would set standards for vendor due diligence and technology, providing banks with a "seal of approval" that they could rely on when on-boarding new vendors or new technology.

Second, we are going to invest resources in development efforts that help tackle tricky supervision issues or help address technological challenges affecting the industry. This is exactly why we established the FDIC's Office of Innovation – FDiTech.

In June, FDiTech launched an initiative – the FDIC's first "hackathon" – that aims to overhaul one aspect of bank supervision: financial reporting.[11]

We invited over 30 technology firms to develop tools for providing more timely and granular data to the FDIC on the health of the banking industry while also making such reporting less burdensome for banks. We selected 15 of these firms to compete in the next phase of the competition, in which they will demonstrate their initial prototypes within 70 days and, if selected to continue, a fully functional prototype in 180 days.[12]

Targeted data sets from banks, which would be more frequently available and more granular than current reporting, could reduce the need for cumbersome quarterly reporting. Such a modernized and automated data system would also improve the ability of supervisors to identify bank-specific and system-wide risks sooner and more efficiently, while simultaneously reducing the compliance burden on individual institutions who voluntarily adopt the technology.

This is not an effort to introduce real-time monitoring of community banks' financial information and operations. In addition to being intrusive, "real-time monitoring" of community banks would be an enormous waste of resources at the FDIC.

What I envision instead is a system that allows banks and regulators – operating from a shared understanding of financial information – to engage more regularly and more informally to discuss operations, understand emerging risks, and resolve questions surrounding new products and services.

I call this approach to supervision "continuous engagement."

Institutions that choose to opt in to this supervisory system would have more regular, informal engagements with the FDIC. With the bank's approval, technology would allow both the FDIC and the bank to have these informal engagements operating from a shared understanding of an-institution's financial health. Think of the technology like a "dashboard" view of an institution's financial health.

In time, I believe this technology can serve as a substitute for the Call Report. And, because we are more regularly engaged with our institutions, it will dramatically reduce the burdens associated with an on-site "annual" examination.

When we are successful, this system will reduce the reporting burden for institutions and the compliance costs of an annual examination, while simultaneously providing greater visibility for the FDIC into an institution's financial health and into the health of the entire financial system. And, because we are engaging more regularly, the FDIC will be able to help institutions identify and mitigate risks to financial health or consumers before they become bigger, more challenging problems.

Our rapid prototyping competition is the first step in the journey to making this "continuous engagement" supervisory model a reality. This transformation – like other ambitious changes to modernize the future of bank supervision – will not happen overnight.
Along the way, FDiTech's research and development efforts will help streamline tech integration at institutions, create new analytic tools that institutions can utilize, and develop new methods for validating consumer compliance associated with an institution's products and services and the technology they use to support those offerings.

I do not have a magic wand to get us there. This will take work. It will take collaboration among the regulatory agencies and with industry.

But, if we want community banks to survive and thrive in the future ... to be dynamic in offering new products and services . . . to use technology to promote financial inclusion and to lower the cost of credit for consumers . . . it is critical that we start the process now.

Thank you again for the opportunity to be here today, and I would be happy to take a few questions.

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[1]*See* FDIC Chairman Jelena McWilliams, "Principles of Supervision," speech before the American Bar Association Banking Law Committee Annual Meeting (Jan. 11, 2019), available at https://www.fdic.gov/news/speeches/spjan1119.html.

[2]*See* 12 U.S.C § 1831p–1.

3*See* FDIC Chairman Jelena McWilliams, "Trust through Transparency," speech before the Federal Reserve System, Conference of State Bank Supervisors, and Federal Deposit Insurance Corporation 2018 Community Banking in the 21st Century Research and Policy Conference (Oct.3, 2018), available at https://www.fdic.gov/news/speeches/spoct0318.html.

[4]*See* Trust through Transparency, available at https://www.fdic.gov/about/initiatives/trust-through-transparency.

[5]*See* Transparency & Accountability – Bank Examinations, available at https://www.fdic.gov/transparency/examination.html.

[6]*See* Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions,84 Fed. Reg. 2366 (Feb. 6, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-02-06/pdf/2018-28273.pdf.

[7]*See* Agencies Issue Statement Reaffirming the Role of Supervisory Guidance (Sept. 11, 2018), available at https://www.fdic.gov/news/press-releases/2018/pr18059.html.

[8]*See* Role of Supervisory Guidance, 85 Fed. Reg. 70512 (Nov. 5, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-11-05/pdf/2020-24484.pdf.

[9]*See* Guidelines for Appeals of Material Supervisory Determinations, 85 Fed. Reg. 54377 (Sept. 1, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-09-01/pdf/2020-19276.pdf.

[10]See FDIC's Subcommittee on Supervision Modernization for the Advisory Committee on Community Banking Holds its Inaugural Meeting (Mar. 6, 2019), available at https://www.fdic.gov/news/press-releases/2019/pr19016.html.

[11]*See* FDIC Launches Competition to Modernize Bank Financial Reporting (June 30, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20079.html. Several firms were added as competitors between the initial announcement and the time the final concept papers were due.

[12]*See* FDIC Selects 14 Companies in Tech Sprint to Modernize Bank Financial Reporting (Oct. 15, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20109.html. One additional firm completed contract negotiations a few weeks after this release.