Remarks to the Texas Bankers Association

Last Updated: August 27, 2021

Hello everyone, thank you for welcoming me to your annual meeting. When I last visited at your 2019 annual convention, no one could have foreseen the monumental change that the pandemic would force upon our lives. But here we are and, despite tremendous challenges, our nation's banks withstood the economic and financial market volatility of 2020, reflecting their strength going into the pandemic. Since then, banks have been instrumental in supporting individuals and businesses through lending and other financial intermediation and by distributing financial support provided by the federal government.

I will begin by touching upon trends in banking conditions that the FDIC is monitoring, and then turn to some of our most important initiatives as we look forward.

Banking Sector Conditions

Over the last year and half, the U.S. banking system showed resiliency and strength in the face of the unprecedented challenges of the pandemic. I remain impressed by the resilience of our banking system and the resoluteness of our bankers who remained on the ground, serving their communities, at a time when we did not know if it was safe to go to the store to buy groceries.

Banks initiated steps to help consumers and their employees immediately upon the outset of the pandemic and well before government support arrived. Among other things, banks: allowed loan modifications with no fees … waived fees on accounts … offered curbside service and in some cases in-home services to customers … provided online or mobile app options to open accounts and conduct financial transactions … and instituted branch sanitation and employee health check procedures. I commend you for keeping your doors open, and keeping communities afloat, including by working around the clock to support lending under the Paycheck Protection Program (PPP).

And all that extraordinary work was not without business challenges. On a national level, banking sector income for 2020 declined from its 2019 level, primarily due to higher provision expenses resulting from both the implementation of the Current Expected Credit Losses accounting methodology (CECL) by large banks and economic stress associated with the pandemic. Despite this overall decline in 2020, banking sector income for the first quarter of 2021 was at a record high, reflecting both economic improvement and a more optimistic economic outlook. However, net interest margin dropped to a new record low of 2.56 percent, driven primarily by the low interest rate environment combined with a decline in total loans driven by low loan demand.[1] We are analyzing call report data for the second quarter of 2021 and are due to release that data in September, though it appears generally consistent with the first quarter of 2021.

Despite the challenges of the pandemic, banks increased their capital levels in 2020 and in the first quarter of 2021, and capital ratios remained strong.[2] Total bank equity rose by 1.2 percent from the fourth quarter of 2020 to $2.3 trillion. These numbers continued despite banks' accommodation of a sharp increase in customer demand for deposits that far exceeded any deposit growth the FDIC had seen in the past, due primarily to continued fiscal support for the economy.[3]

The low interest rate environment coupled with economic uncertainty will continue to challenge the banking sector, placing downward pressure on revenue and net interest margin. However, the banking sector maintains strong capital and liquidity levels, which can mitigate the impact of potential future losses.

Initiatives Looking Forward

Despite the pandemic, the FDIC has not lost sight of our forward-looking initiatives, including many of those that have been a focus of my chairmanship from the beginning. Chief among these is creating a financial regulatory system that fosters – rather than stifles – innovation.

How I can use the office I humbly hold to promote American competitiveness has been on my mind recently. Last month, I celebrated my 30th anniversary of immigrating to the United States. I came with $500 tucked into the pocket of my Levi's jeans and sporting a leather biker jacket, both quintessential symbols of American culture and innovation that I have come to revere. And though I did not know much more about America than what I had seen on TV – and I would be remiss if, on Texas soil, I did not mention how much I loved "Dallas" (*if only someone would tell me who* ***really*** *shot JR?*) – I wanted badly to be part of the American fabric. I certainly was not the only one, as millions of young people like me throughout the world sought to emulate American cultural style.

It is not hard to see why. The 20th Century was America's century. If you were a kid growing up on the wrong side of the Iron Curtain in the 1970s, you quickly realized that "Bazooka" was a superior chewing gum, Levi's 501's were the best jeans ever, and that anyone who could afford them was wearing Converse Chuck Taylor's. It was the century of many "firsts" of American inventions: the first mass produced automobile,[4] the first commercial flight,[5] the first personal computer,[6] the first cellphone,[7] and many more. And as bright-eyed kid who loved to read and study, I became increasingly convinced that my destiny was in the United States. From our modest surrounding in the Balkans, the United States looked like a brilliant jewel, a beacon of hope, a land of opportunity – "a shining city on a hill." It was a land where someone who worked hard and developed skills could achieve pretty much anything.

In the 30 years since I landed in San Francisco, the world around us has changed dramatically. Internationally, America – and our values, culture, and influence – face increasing competition from around the world, including from regulatory systems that focus intently on promoting technological advances and taking on the mantle from the United States. How do we compete in that environment? How do we ensure that the 21st Century remains America's century? People can disagree on a lot of things – as I am keenly aware, coming from

Washington, DC – but it is difficult to dispute that fostering and encouraging innovation will be critical to ensure America's preeminence in this century.

Innovation *in financial services* in particular is important because lending and access to capital is the engine that propels ideas into inventions that better people's lives. I do not need to tell this audience what a crucial role community banks play in supporting entrepreneurship and small businesses,[8] but many community banks struggle to remain competitive given technological changes and the demands of increasingly tech-savvy consumers. At the same time, many disadvantaged communities continue to struggle economically, including as a result of the disproportionate impact of the pandemic. And despite much improvement over the past decade, we continue to have 7 million unbanked households in the United States,[9] translating into many more individuals who do not have a basic banking relationship.

Innovation will be critical to addressing these challenges in the future. Whether by allowing community banks themselves to adopt new technologies or by allowing them to partner with fintechs that develop new products, innovation can reduce the costs of adopting new technology by community banks and give them a fighting chance to provide the types of financial services their communities need and want. Innovation in financial services is already creating tools that can broaden access to credit and to financial services. For example, new technology can use alternative sources of data to give access to credit to people with low or no credit scores.

The pandemic has highlighted the critical role of innovation and technology. As the supervisor of the largest number of banks in the country, the FDIC could not have done its job last year without innovation in supervisory channels. The FDIC had to enhance its technology capabilities in real time in order to fulfill our mandate, and the experience only underscored how technology underpins our operations, from how we assess risk to how we engage with counterparties. Adopting new technology, and quickly, also allowed banks to continue to meet the needs of their communities during this time.

As a banking regulator, our role in pushing forward innovation is limited. But we can do more to foster an environment in which smaller banks can adopt new technologies and are comfortable coming to us with their proposals. New technologies and tools certainly may pose different types of risks, but as regulators we can and must learn to manage those risks without throwing out the proverbial baby with the bath water.

To this end, we have tried to reduce the barriers that our regulations and the way we regulate may pose on innovation. One of my first initiatives as chairman was "Trust through Transparency,"[10] which tasked each division and office within the FDIC with being accessible, understandable, responsive, and accountable to the public. In 2018 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.

Transparency is essential to fostering innovation, because firms perform best when there is regulatory certainty and the rules of the road are clear. We have worked hard to make our regulations clearer, easier to understand, and more predictable. We delineated what constitutes a rule versus what constitutes supervisory guidance, and the role of each in our regulatory ecosystem, including bank exams.[11] We also approved guidelines for a new Office of Supervisory Appeals to hear appeals by banks of supervisory determinations made by examiners,[12] in order to support a robust appeals process and promote consistency among examiners across the country and accountability at the agency.

We have taken a look at outdated regulations that may hinder progress. For example, at the end of 2020, the FDIC Board approved a final rule updating our brokered deposits regulations, the first meaningful update to the brokered deposits regulations since the rules were first put in place approximately 30 years ago. The new rule encourages innovation in how banks offer services and products to customers by removing regulatory hurdles to certain types of innovative partnerships between banks and fintechs.[13]

The FDIC is taking a multi-pronged approach to tackling these issues, but we cannot move the needle alone. There is a network of actors, both public and private, that must act to cause change. A key part of our effort going forward, therefore, is using our stature and ability to connect external stakeholders in the banking sector to propel innovation forward.

Mission-Driven Bank Fund

I will share three examples of novel initiatives we are actively working on … *which I hope will make clear that this is not your grandmother's FDIC* . First, our Mission-Driven Bank Fund. Based on my conversations with our Minority Depository Institutions (MDIs) and Community Development Financial Institutions (CDFIs) early in my tenure, I learned that what these institutions need most is capital. So I challenged the FDIC to come up with a framework that would match these banks with investors interested in the particular challenges and opportunities facing those institutions and their communities. In November 2020, we announced the establishment of a novel investment vehicle, the Mission-Driven Bank Fund, which will channel private sector investments to support MDIs and CDFIs.[14]

The idea of this fund came to me on a flight somewhere over the United States as I was flipping through TV channels on the small monitor mounted on the back of the seat in front of me. I came across a very successful television show – *whose name, our lawyers tell me, I am not supposed to mention but it may have words "shark" and "tank" in the title* – in which entrepreneurs present their business ideas to a group of potential investors. And I thought to myself: "Why not do something similar for our MDIs?" Initially, this idea was met with raised eyebrows at the FDIC – not because we did not want to do this, but because we have never done it! In fact, no regulatory agency has done something even remotely similar. After many hours of deliberation that included a thorough review of the FDIC's statutory authorities, here we are . . . just about to unveil the Mission-Driven Bank Fund.

This Fund has two anchor investors and one founding investor. The anchor investors are hiring a fund manager and working towards a first closing in the fourth quarter of 2021 so that the fund can receive pitches from banks early in the first quarter of 2022. The FDIC will retain an advisory role to support the fund's mission focus, but will not contribute capital to, manage, or be involved in investment decisions of the fund.

Voluntary Third-Party Certification Program

The second initiative I will touch upon is our voluntary third-party certification program. Last year, we asked stakeholders to comment on a groundbreaking approach to facilitate technology partnerships. Our request for information (RFI) proposed a public/private standard-setting partnership and voluntary certification program that would help reduce the cost and uncertainty associated with the introduction of new technology at an institution.[15]

The on-boarding and due diligence process can be costly and time consuming for both banks and their potential technology vendors. These challenges are often amplified at community banks with tight budgets and limited technology expertise. The voluntary certification program described in the RFI would create a standard setting organization (SSO) to establish standards for due diligence of vendors and for the technologies they develop.

Standardizing the due diligence process and removing regulatory and operational uncertainty surrounding technologies could fundamentally improve the ability of banks to safely and confidently partner with technology firms while allowing the FDIC greater ability to engage in a horizontal review of different products, services, business models, and risk management practices of third-party service providers. This program will create a path forward to increasing the competitiveness of our community banks and their ability to meet the needs of consumers in the modern age. The comment period for the RFI ended this past June, and the FDIC continues to pursue the concept actively.

Improving Reporting through Rapid Prototyping

Finally, I will touch upon an initiative we are calling the "rapid phased prototyping competition." It is the first of many "tech sprints" organized by the FDIC this past year through which we are bringing together external stakeholders to tackle problems identified by the FDIC.

For this particular tech sprint, we hope to tackle the burdens that the current call reports place on supervised institutions and to enhance their value to the FDIC. Although these reports provide critical data to the FDIC, they do so with several months' delay, thereby reducing the utility of the reporting.

Last year, more than 30 technology firms were invited to participate in this rapid phased prototyping competition,[16] 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. Earlier this month, we asked four participants to propose a proof of concept for their technologies – either independently or jointly.[17] Our goal is to conduct a pilot program with up to nine FDIC-supervised institutions of various sizes and technological maturity to test the reporting technologies and determine their potential to scale. Tools like those developed in this competition will help pave the way for more seamless and timely reporting of more granular data for banks that voluntarily choose to adopt the technology. Moreover, the associated improvements in data structure, access, and processing may also help support more efficient back-office operations and more effective integration of new technologies.

We have several more tech sprints in the works to tackle important issues, including a tech sprint that is exploring new technologies and techniques that would help expand the capabilities of community banks to meet the needs of unbanked households.[18] These tech sprints harness the power of the FDIC to bring together teams with a diverse set of experiences to solve pressing issues. They allow us to engage with participants in a less formal way than our usual supervisory process, and to play a role in supporting the innovative spirit that exemplifies the best of our country.

Conclusion

In conclusion, one may ask why innovation matters to community banks? Small banks are slowly disappearing from America's landscape. Based on 2020 Summary of Deposit data, 613 counties are only served by community banking offices, 132 counties have only one banking office, and 34 counties have no banking offices at all.

I have noted on many occasions how vital community banks are to their communities. You support the small businesses, farms, libraries, and entrepreneurs that help small towns, rural communities, and inner-city locations stay economically relevant and even thrive. If our community banks are unable to adapt to innovation that is sweeping their industry and which their customers have grown to expect, small banks will simply not survive.

I do not profess to know what the right number of banks in the U.S. is, but I recognize that community banks have to be competitive in order to survive. The FDIC is taking on the challenge of promoting innovation and creating a regulatory environment that will make it easier for small banks to adopt new technologies and thrive.

Thank you.

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[1] *See* FDIC, Quarterly Banking Profile, First Quarter 2021, available at https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2021mar/qbp.pdf#page=1 (PDF).

[2] *See id* . at 5-7.

[3] See FDIC, Quarterly Banking Profile, Second Quarter 2020, available at https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2020jun/.

[4] *See* U.S. Nat'l Museum, Smithsonian Institution, Bulletin - United States National Museum no. 213 (1957), available at https://library.si.edu/digital-library/book/bulletinunitedst2131957unit

[5] *See* U.S. Nat'l Museum, Smithsonian Institution, The Early Years of Transpiration 1914-1927, available at https://airandspace.si.edu/exhibitions/america-by-air/online/early_years/early_years01.cfm

[6] *See* U.S. Nat'l Museum of American History, Altair 8800 Microcomputer, available at https://americanhistory.si.edu/collections/search/object/nmah_334396

[7]*See* U.S. Nat'l Museum of American History, Dynatac Cellular Telephone, available at https://americanhistory.si.edu/collections/search/object/nmah_1191361/

[8]American small businesses, which made up almost half of private-sector employment and over 65 percent of net new jobs between 2000 and 2019. SBA, "Frequently Asked Questions About Small Businesses," accessed June 9, 2021, https://cdn.advocacy.sba.gov/wp-content/uploads/2020/11/05122043/Small-Business-FAQ-2020.pdf (PDF), accessed June 9, 2021.

[9]*See* How America Banks: Household Use of Banking and Financial Services, 2019 FDIC Survey, available at https://www.fdic.gov/analysis/household-survey/2019report.pdf (PDF).

[10]*See* Remarks by Jelena McWilliams, FDIC Chairman, "Trust through Transparency," 2018 Community Banking in the 21 st Century Research and Policy Conference, St. Louis, MO (Oct. 3, 2018), available at https://archive.fdic.gov/view/fdic/11607.

[11]*See* FDIC, FDIC Approves Rule on the Role of Supervisory Guidance (Jan. 19, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21005.html.

[12]*See* FDIC, FIL 04-2021, Revised Guidelines for Appeals of Material Supervisory Determinations (Jan. 19, 2021), available at https://www.fdic.gov/news/financial-institution-letters/2021/fil21004.html.

[13]*See* Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 86 Fed. Reg., 6742 (Jan. 22, 2021), available at https://www.fdic.gov/news/board/2020/2020-12-15-notice-dis-a-fr.pdf (PDF).

[14]*See* FDIC, FDIC Seeks Financial Advisor to Establish New "Mission-Driven Bank Fund" to Support FDIC-Insured Minority Banks and Community Development Financial Institutions (Nov. 18, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20125.html.

[15]*See* Request for Information on Standard Setting and Voluntary Certification for Models and Third-Party Providers of Technology and Other Services, 85 Fed. Reg. 44890 (July 24, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-07-24/pdf/2020-16058.pdf (PDF)

[16]*See* FDIC, FDIC Launches Competition to Modernize Bank Financial Reporting (June 30, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20079.html..

[17]*See* FDIC, FDIC Requests Four Companies to Submit Pilot Proposals in Next Phase of Rapid Phased Prototyping Competition (Aug. 9, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21070.html.

[18]*See* FDIC, FDITECH Launches Tech Sprint to Reach More Unbanked People, FIL-43-2021 (June 16, 2021), available at https://www.fdic.gov/news/financial-institution-letters/2021/fil21043.html.