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and

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The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

I am pleased to testify before the Subcommittee on Digital Assets, Financial Technology, and Inclusion to discuss the activities and initiatives of the Office of the Comptroller of the Currency's (OCC) Office of Financial Technology. My testimony today focuses on the OCC's supervision and regulation related to banks' use of new and emerging financial technologies (fintech), often as part of a broader innovation strategy.

The OCC charters, supervises, and regulates more than 1,000 national banks, federal savings associations, and federal branches and agencies of foreign banks (collectively, "banks"). These institutions range in size from very small community banks to the largest, most globally active banks operating in the United States. The vast majority of the institutions we supervise have less than $1 billion in assets, while 55 have greater than $10 billion in assets. Together, OCC-supervised institutions hold more than $15 trillion in assets, representing nearly 65 percent of all the assets held in commercial U.S. banks.

I currently serve as the OCC's Acting Deputy Comptroller for the Office of Financial Technology, in addition to my long-term position as Deputy Comptroller for Compliance Risk Policy. The Office of Financial Technology is responsible for the analysis and evaluation of financial technology innovations, trends, emerging risks, and potential implications for OCC supervision and OCC-supervised banks. We also support the development of policy guidance, outreach, knowledge sharing, and supervision resources for financial technology-related business models, platforms, and applications. As Acting Deputy Comptroller, I am actively involved in updating and enhancing the structure and capabilities of our Office of Financial Technology to ensure the agency's expertise and ability to adapt to the rapid pace of technological changes in the banking industry and to provide high-quality supervision of matters relating to evolving financial technologies, including bank-fintech partnerships.

Responsible Innovation and the Office of Financial Technology

Over the years, the OCC has adapted its supervisory approach to address the technological innovations by banks, and to support and promote responsible innovation in the banking industry to expand access to credit and capital, improve operations, and support full and fair participation in America's banking system. Currently, technological changes and rapidly evolving consumer preferences are again reshaping the financial services industry and creating new opportunities to provide consumers, businesses, and communities with more access to, and options for, products and services. As articulated in our Responsible Innovation Framework in 2016,[1] a responsible approach to financial technology innovation begins by considering whether the innovation meets an identifiable customer or business need, while progressing in controlled stages where risks can be identified, measured, and managed at each stage. In order to achieve responsible and sustainable innovation, banks should engage risk managers, compliance professionals, and regulators from the outset and through each step of the process.[2] Progressing in this manner promotes trust by the public, as well as a safe, sound, and a fair banking system.

In 2016, the OCC became the first federal banking agency to establish a dedicated Office of Innovation to provide a regulatory framework for responsible financial technology innovation and to ensure corresponding supervisory approaches. For the last six years, the OCC's Office of Innovation has conducted external meetings, outreach, and formal office hours in which stakeholders –including technology firms, banks, trade associations, academics, and consumer

[1] OCC Issues Responsible Innovation Framework | OCC

[2] New, Modified, or Expanded Bank Products and Services: Risk Management Principles | OCC (treas.gov); Acting Comptroller of the Currency Michael J. Hsu Remarks to the American Bankers Association Risk and Compliance Conference, "Tokenization and AI in Banking: How Risk and Compliance Can Facilitate Responsible Innovation," on June 16, 2023 (occ.gov);

groups – interact with the agency to facilitate the ability of banks to responsibly adopt innovation and associated advanced technologies. In addition, the Office fostered internal OCC staff awareness of responsible innovation and emerging trends, enhanced the skills of examiners, and developed processes to build and leverage OCC experience and expertise in innovation trends and approaches.

In October 2022, the OCC announced that it would build upon this successful work by creating the Office of Financial Technology, which incorporates the Office of Innovation.[3] As we expand the staff and resources of the Office of Financial Technology, we are increasing our core of experts who possess fluency in both financial technology and bank supervision, as well as extensive knowledge and expertise on financial technology platforms and applications. Financial Technology Policy Specialists provide subject matter expertise and support to senior leaders throughout the agency, as well as coordinate regular knowledge sharing activities. The staff also provide real-time support for supervision teams in the agency's Large and Midsize and Community Bank supervision units as they evaluate the evolving impact of financial technology on banks and examine banks' fintech activities. The Office of Financial Technology is focused on ensuring that the agency remains a leader in supporting responsible financial technology innovation and providing high-quality supervision of banks' financial technology implementation and bank-fintech partnerships. The Office works as part of the OCC's Bank Supervision Policy (BSP) department and supports BSP's risk monitoring and formulation of policies and procedures for the effective supervision and examination of national banks and federal savings associations.

[3] OCC Establishes Office of Financial Technology | OCC

The OCC maintains a technologically neutral posture toward new and emerging financial technologies, neither requiring, nor prohibiting adoption of any particular technology or business model. The agency regularly issues principles-based guidance that is designed to accommodate evolving technologies and business models. OCC-supervised institutions implementing fintech solutions or partnering with non-banks to provide banking products and services remain subject to all of the regulatory requirements associated with the underlying activity, regardless of the chosen technology, business model, or use of a third party for implementation.[4]

Areas of Supervisory Focus

The Office of Financial Technology enhances agency expertise and provides support for regulation and supervision of all aspects of financial technology innovation in the federal banking system. The OCC's current areas of focus include matters involving bank-fintech partnerships, artificial intelligence, digital assets and tokenization, as well as other new and changing technologies and business models that affect OCC-supervised banks.

Banks' relationships with third parties, including fintech companies, continue to expand. Some OCC-supervised banks are partnering with non-bank fintech companies to expand their reach with respect to offering traditional bank products and services, such as deposit accounts, payments, and consumer lending. The use of third parties has significant potential benefits, but strong third-party risk management is essential to avoid harm to consumers or weakening of bank safety and soundness. Earlier this year, the OCC, FDIC, and Federal Reserve published "Interagency Guidance on Third-Party Relationships: Risk Management."[5] This document builds

[4] Third-Party Relationships: Interagency Guidance on Risk Management | OCC

[5] Third-Party Relationships: Interagency Guidance on Risk Management | OCC

on the OCC's guidance from 2013 and reminds banks of their responsibility to operate in a safe and sound manner and in compliance with applicable laws and regulations regardless of whether their activities are performed in-house or outsourced. The guidance recognizes that not all third-party relationships reflect the same level of risk and therefore not all require the same level of risk management. The guidance also reinforces the agencies' expectations for risk-based governance, risk management, and oversight through all stages of any third-party relationship's lifecycle.

The OCC also recognizes the considerable and growing interest by the banking industry in a wide range of uses for artificial intelligence (AI). AI algorithms and systems have similarities to other types of complex mathematical models and technologies that banks have long used to support their activities. When used appropriately, AI has the potential to strengthen safety and soundness, enhance consumer protections, improve the effectiveness of compliance functions, improve systems for addressing financial crime, and increase fairness in, and fair access to, the banking sector. AI can also be used to enhance bank customer services and products ranging from the use of chat-bots that aid in directing customer inquiries and assisting with online account openings, to supporting more efficient credit underwriting, which has the potential to promote greater access to banking services by underserved communities. Banks also are exploring newly developed kinds of AI such as "generative" AI that are trained on large data sets and can be used to generate text, images, videos, or other outputs from a given prompt. OCC-supervised institutions are generally approaching generative AI with caution and its use is not widespread.

With regard to all uses of AI, the OCC remains focused on the potential risks of adverse outcomes if bank use of AI is not properly managed and controlled. Potential adverse outcomes can be caused by poorly designed underlying mathematical models, faulty data, changes in model assumptions over time, inadequate model validation or testing, or limited human oversight. Key risks include a lack of explainability of outcomes, bias or inaccuracies due to poor quality data or data management, failure to preserve consumer privacy and data security, and risks resulting from reliance on third party vendors if banks do not implement an effective third-party risk management program. The OCC continues to conduct robust, risk-based supervision, monitor the industry, and conduct research efforts to ensure that the agency keeps pace with changes in AI use in the financial sector.

The agency also recognizes the promise and transformative potential of other technologies, including distributed ledger technology (DLT), and maintains a careful and cautious approach to their use in the federal banking system while industry standards develop, and important legal and ethical questions are addressed.[6] A very small number of OCC supervised banks have publicly launched crypto-asset products. A few banks also have publicly announced their development of DLT-based intrabank systems. The financial industry's attention in the digital asset space is shifting from crypto-assets to the tokenization of real-world assets and liabilities. Tokenization is driven by solving real-world settlement problems and shows promising potential for being developed in a safe, sound, and fair manner. Next February, the OCC will host a public symposium on tokenization to explore the legal foundations for

[6] Acting Comptroller of the Currency Michael J. Hsu Remarks to the American Bankers Association Risk and Compliance Conference, "Tokenization and AI in Banking: How Risk and Compliance Can Facilitate Responsible Innovation," on June 16, 2023 (occ.gov)

tokenization of real-world digital assets and liabilities, tokenization use cases, and risk management and control considerations.[7]

The agency is also aware that advances in open banking will have implications for institutions of all sizes as well as for our supervision of them.[8] These implications may include liquidity risk from increased account portability; compliance risk; and operational risk, including cybersecurity risk and third-party risk. The OCC is carefully monitoring developments in this area and looks forward to continuing to engage with our fellow regulators on open banking issues.

The OCC is strongly committed to reducing inequality in banking and increasing access to traditional financial services, and these goals have the potential to be advanced by financial technology innovation in the banking system. The OCC regularly engages in a wide range of outreach efforts to support these goals. For example, the OCC convenes banking and other financial services industry stakeholders to work collaboratively toward removing barriers to financial inclusion at the local and national levels through Project REACh, the Roundtable on Economic Access and Change.[9] Project REACh's multi-pronged approach includes an Alternative Credit Assessment Workstream where stakeholders work together to improve access to credit for the 50 million Americans without credit scores or thin credit files. The workstream has convened financial institutions, technology firms—including fintechs—and community organizations to explore, develop, and analyze credit assessment methods that can consistently predict a borrower's ability to repay. The OCC also works through both its Minority Depository

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[7] OCC to Host Symposium on the Tokenization of Real-World Assets and Liabilities | OCC.

[8] Acting Comptroller of the Currency Michael J. Hsu Remarks at FDX Global Summit, "Open Banking and the OCC,"

[9] Project REACh - Fact Sheet (occ.gov)

Institution Advisory Council and a Project REACh working group to focus on addressing financial technology-related challenges facing MDIs.

Rapid financial technology innovations require a robust and responsive approach by financial regulators. The OCC is committed to helping banks innovate while evolving and growing in a safe, sound, and fair manner. Our strong risk management expectations foster a combination of controls, culture, and prudence that enable banks to implement responsible and purposeful financial technology innovations without creating undue risk in the banking system.

Conclusion

The OCC is committed to ensuring that OCC-supervised banks operate in a safe, sound, and fair manner, meet the credit needs of their communities, treat all customers fairly, and comply with laws and regulations, amidst significant technological change in the industry. As we work to ensure that the federal banking system remains a source of strength to the U.S. economy, we will continue to support responsible financial technology innovation by OCC-supervised banks so that the federal banking system remains well positioned to respond to community and consumer needs into the future.