Remarks by

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Good morning. I'm glad to join you today and have the opportunity to talk with you about community banking—the heart and soul of banking across our nation. Events like these that bring us outside the Beltway are important for reminding regulators of our real purpose—ensuring that we have a safe and sound banking system that can responsibly serve consumers, businesses, and communities across the nation. Community banks like yours play an outsized role in delivering banking services in small towns and rural communities nationwide. Our nation and economy are stronger when community banks are a healthy, vibrant part of our financial services industry.

For more than three decades as a regulator at the state and national levels, my personal focus has been the vitality of our community banks. While it's true that we oversee the nation's few dozen largest and internationally active banks, most of our time and resources are devoted to supervising nearly 1,200 community institutions like yours. For the short time I have with you this morning, I'd like to share what the OCC is doing for community banks by discussing our supervisory priorities, our responsible innovation initiative, and our thoughts on how community banks can use collaboration to meet their business goals and better serve their customers.

Regarding our supervisory priorities, we published the OCC's *Fiscal Year 2017 Bank Supervision Operating Plan*[1] so that banks and other stakeholders could plainly see our priorities for large, midsize, *and* community banks regarding safety and soundness as well as compliance and consumer protection. At a very high level, we are focused on banks' business model sustainability and viability, commercial and retail loan underwriting, operational resiliency, Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance management, and processes to address new regulatory requirements. Our *Semiannual Risk Perspective* has pointed to these concerns on a number of recent occasions.[2] For community banks, that means our exam teams will develop and execute risk-based supervisory strategies for each bank that are tailored to the specific risks and particular circumstances of that bank. As appropriate, examiners will consult and coordinate on supervisory strategies with other agencies, primarily the Federal Reserve, the FDIC, and the CFPB to avoid unnecessary duplication.

As Comptroller, though, I want to speak to one overarching consideration that should be front of mind for all bank executives and boards—strategic risk. In *A Common Sense Approach to Community Banking*, we described strategic risk as "the risk to current or anticipated earnings, capital, or franchise value arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes."[3] What that really means is this: you need to have the *right* plan to meet *your* business goals in *your* market.

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[1] See *Fiscal Year 2017 Bank Supervision Operating Plan*. September 14, 2016 (https://occ.gov/news-issuances/news-releases/2016/nr-occ-2016-112a.pdf).

[2] See *Semiannual Risk Perspective*, Spring 2016 (https://occ.gov/publications/publications-by-type/other-publications-reports/semiannual-risk-perspective/semiannual-risk-perspective-spring-2016.pdf).

[3] See *A Common Sense Approach to Community Banking*. June 2013 (https://occ.gov/publications/publications-by-type/other-publications-reports/common-sense.pdf).

Strategic risk permeates all bank activities, and mitigating it goes beyond just analyzing your written strategic plan. It means asking different questions. Instead of, "Is this product performing?" or "Are we meeting our growth goals?" you have to ask, "Are we offering the right products, and have we identified the right goals? Have we properly identified the needs of our customers and communities? Do we have a plan for adapting to the changing marketplace in the next five or 10 years? Has our board adopted approaches and policies consistent with the bank's long-term business model, and have we articulated our goals effectively?" OCC's expectations are that all banks, large and small, need some degree of strategic planning tailored to each bank's goals and risk appetite, as well as size and complexity. Strategic planning helps a community bank position its business, identify its best opportunities, and make hard choices about the unknown and uncontrollable. The future is always uncertain, but strategic planning provides a context for making decisions.

Examples of actions that could affect your bank's strategic risk include entry into a new market, opening or closing a branch or loan office, launching a new product, or canceling a service. Entering new lines of business without a well-defined strategy, thorough due diligence, appropriate risk controls, or sufficient capital is a common pitfall.

One particular issue testing banks' strategic risk today is the tectonic shift underway regarding innovation and financial technology. Technological advances, together with evolving consumer preferences, are reshaping the financial services industry. Over the last several years, a large and growing number of nonbank financial technology companies (fintechs) have emerged to provide financial products and services through alternative platforms and delivery channels. As of 2015, the number of fintech companies in just the United States and United Kingdom alone had reached 4,000.

One factor in the growth of fintech companies is the 85 million millennials entering the financial marketplace who have demonstrated more willingness than earlier generations to change financial service providers or use multiple providers to meet their needs. While fintech companies are still a small portion of the industry, their rapid growth requires banks *and* regulators to ask big-picture questions about the future of banking, how consumer needs are being met, and whether we have the necessary regulatory tools and structure to ensure that the changes occur in a safe and sound manner, promote financial inclusion, and avoid consumer abuse.

We started our responsible innovation initiative more than a year ago[4] to get at these questions and to make certain that institutions with federal charters have a regulatory framework that is receptive to responsible innovation and supervision that supports it. We believe innovation can promote financial inclusion by expanding services to the unbanked and underserved. It can provide more control and better tools for families to save, borrow, and manage their financial lives. And, it can help community banks like yours scale operations efficiently to compete in the marketplace while making transactions safer and faster.

For it to work, we saw that you needed a different conduit into the OCC, one that was not on-site examination driven. We recognized that you needed more open dialogue, receptive to *responsible* innovation, and capable of providing technical assistance when necessary. We also saw that we needed to improve our own awareness and understanding of the changes occurring and needed to establish a core staff and processes of building and maintaining our awareness and expertise of financial technology and innovation affecting the federal banking system.

[4] See "Remarks before the Federal Home Loan Bank." August 7, 2015 (https://occ.gov/news-issuances/speeches/2015/pub-speech-2015-111.pdf).

Transparency is a key element. We have been transparent at every phase in the development of our regulatory framework—publishing the principles guiding our work in March;[5] soliciting comment from industry, academics, and consumer and community groups; and hosting a public forum to discuss issues raised during the comment period. Then, our Innovation Framework Development Team went to work developing specific recommendations.

In October, I approved the team's recommendations and established a stand-alone Office of Innovation to develop a formal framework for responsible innovation.[6] We have an acting Chief Innovation Officer who reports to me. When fully operational in the first quarter 2017, the Chief Innovation Officer will be supported by a small staff in our headquarters as well as in New York and San Francisco. It will be the central point of contact and clearinghouse for requests and information related to innovation. It will

- establish an outreach and technical assistance program for banks and nonbanks,
- conduct awareness and training activities for OCC staff,
- encourage coordination and facilitation,
- establish an innovation research function, and
- promote interagency collaboration.

This new office will offer real value to community banks by providing outreach and technical assistance to help banks work through innovation-related issues and understand regulatory concerns early and assist banks in explaining regulatory expectations to the fintech

[5] See *Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective*. March 2016 (https://occ.gov/publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ-perspective.pdf).

[6] See *Recommendations and Decisions for Implementing a Responsible Innovation Framework*. October 2016 (https://www.occ.gov).

companies with whom they partner. The office will share success stories, lessons learned, and hold "office hours" where bankers and others in the industry can consult OCC experts directly, outside of supervision channels. We're taking these actions because we know that for innovation, and particularly financial technology, to deliver on its promise, we need to support community banks through a supervisory approach that encourages responsible innovation that is safe and sound, promotes financial inclusion, and avoids abusing customers.

While larger banks and some smaller ones may have the resources to fund innovation labs, conduct their own research and development, or even purchase a more mature fintech company, many smaller banks may have to seek alternative ways to incorporate innovation into their strategies and business plans. One way to do that is through collaboration, which we see as a useful tool for community banks to reduce costs, better serve customers, and even reach new markets.

In 2015, we published a paper describing how community banks could potentially collaborate in safe and sound ways that incorporates appropriate risk management and comprehensive strategic planning.[7] For banks that wish to explore innovative solutions, I can think of at least two areas where collaboration can help—by reducing the costs of vetting and overseeing innovative third-party service providers and by partnering directly with nonbank fintech companies that complement your strategic business plans.

I understand the hesitation banks may have about partnering with fintech companies or using their innovative products. By definition, they are new. Their technology may not be as familiar or easily understood, and most don't have long-term track records that could provide a

[7] See *An Opportunity for Community Banks: Working Together Collaboratively*. January 2015 (https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-other-community-banks-working-collaborately.PDF).

measure of reassurance. Vetting new companies can be costly and daunting, and small banks without specific expertise may have to rely on yet another third party to support their due diligence. Even after entering a partnership, overseeing the vendor can present similar challenges.

Third-party risk management is a key risk in this context and the responsibilities of the bank include:

- Assuring an outsourcing arrangement aligns with the bank's strategic direction;
- Assessing the appropriateness of the fee structure for the services received;
- Implementing necessary user controls; and
- Monitoring service providers' performance.

Working together to evaluate and monitor third-party service providers can help *manage* the risk, and some community banks already are finding success with this type of collaboration. Many community banks that use large technology service providers already belong to user groups that work together to manage the third-party relationship. In addition, we are beginning to see the emergence of similar groups and associations that conduct assessments of service providers' fundamental controls and financial condition and share the information with their members. Some other examples of where collaboration can help include:

- Researching references, financial condition, customer complaints, and litigation;
- Validating legal and regulatory compliance capabilities, including information security controls, operating resilience, and MIS capabilities;
- Assessing insurance coverage; and
- Sharing experiences of working with particular providers.

This morning I have covered a lot of ground. I am very optimistic about the future of community banks and the benefits innovation can provide to make our financial system stronger, more efficient, and even more capable of serving the families, businesses, and communities who rely on your institutions every day. I hope that behind the details of each of the topics covered today you heard the support and passion that I have for community banks and your role in our nation's economy and in serving as anchors in your communities. It was my honor to join you today, and I look forward to any questions you have.