Financial Institution Supervision and Credit
FEDERAL RESERVE BANK
OF SAN FRANCISCO

SUPERVISION IN BRIEF

A REGULATOR'S PERSPECTIVE ON ISSUES FACING 12TH DISTRICT BANKS

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Greetings!

As we close out another year and further extend the longest U.S. economic expansion in history, 12th District banks remain in sound condition across all financial measures. We continue to monitor several financial areas closely—including CRE lending concentrations, loan growth, and lengthening asset maturities—but are encouraged by both liquidity and capital levels, which have positioned District banks to better weather any potential downturn in the economic cycle. You can read more about banking conditions through the third quarter 2019 in the current issue of First Glance 12L.

The overall financial health of the industry has allowed bankers and bank supervisors alike to better assess and understand a number of increasing nonfinancial risks, such as cyber security, information technology, cloud usage, and data governance. This focus isn't unique to the 12th District. Last month, the Federal Reserve System issued its semiannual Supervision and Regulation Report. This report contains quantitative and qualitative information about banking system conditions, discusses regulatory developments, and identifies the Federal Reserve's 2020 supervisory priorities for our LISCC, large, regional, and community portfolios. Not surprisingly, many of the priorities for each of the portfolios revolve around nonfinancial risks. In particular, one of the 2020 supervisory priorities for the community institution portfolio is the operational risk associated with the intersection of community banking and fintech.

We believe that the San Francisco Fed is particularly well positioned to serve as a thought leader in the nonfinancial risk space more broadly, but specifically with regard to fintech-related developments. As I mentioned in my inaugural *Supervision in Brief* in August 2017, the Financial Institution Supervision and Credit (FISC) group has formed a team of fintech analysts to analyze fintech innovations and their impacts on financial institution supervision, community development, financial stability, payments, and other areas. We have also launched a public facing outreach program called Fintech Navigate to engage with firms and other industry groups as they try to navigate the regulatory and supervisory system in support of their involvement with financial technologies. This is a real issue for community bankers, as our former EVP and head of supervision, Teresa Curran, discussed in her *Community Banking Connections* article, "Fintech: Balancing the Promise and Risks of Innovation."

To expand our knowledge and deepen our thinking in this area, our fintech team recently hosted a Data Symposium, *The Role of Consumers in the Data Ecosystem*. Partnering with FinRegLab, a nonprofit innovation center that tests new technologies and data to help inform public policy, we brought together 130 subject matter experts—from regulatory bodies, financial institutions, technology firms, academia, and consumer advocacy—to dissect the inherent tradeoffs between capturing the benefits of data while mitigating the risk to consumers.

Data, and consumer financial data in particular, increasingly underpins financial services and the evolution of the financial system. Furthermore, the rate and proliferation of data generation is increasing rapidly as new innovators enter the market and consumer engagement increases. Consumers have found that viewing and using financial data, such as balance and transaction information, in new and combined forms can improve their financial well-being. However, financial institutions have been feeling increasing pressure to contribute to these new information-sharing systems while maintaining the required compliance with financial data protection laws and third-party risk management.

Sharing sensitive financial information with unknown entities poses a clear risk to institutions and their customers. Federal Reserve Governor Lael Brainard has said, "…responsibility for establishing appropriate norms in the data aggregation space should be shared, with banks, data aggregators, fintech developers, consumers, and regulators all having a role."[1] The challenge will be in defining those norms and, importantly, the supervisory structure to support them.

Not surprisingly, the Symposium did not give us an exact path forward. However, it was invaluable to establish a shared vision on the importance of 1) protecting consumer financial data, whether through third-party risk management, an expanded perimeter, or something different and 2) supporting a strong ecosystem of innovation, competition, and collaboration among traditional financial institutions and fintech firms. You can read more about this event in the SF Fed Blog, as well as in a full report on the Symposium, which will be released early next year.

We will continue to provide forums for these types of discussions. If you are interested in learning more about our focus on data or in discussing how the intersection of banking and fintech may affect your institution, please don't hesitate to reach out to a member of our Fintech Team.

Wishing you and your families a happy and healthy holiday season,

Best regards,
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[1] Federal Reserve System Governor Lael Brainard, "Where Do Consumers Fit in the Fintech Stack?," at FinTech Risks and Opportunities: An Interdisciplinary Approach, Ann Arbor, Michigan, November 16, 2017.