CONSIDERATIONS FOR INNOVATION WITH FEDERAL BANK REGULATORS

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Each of the federal bank regulatory agencies, as well as the National Credit Union Administration and the Financial Crimes Enforcement Network ("FinCEN") (collectively, the "Agencies"), have recently taken significant steps toward fostering innovation in the financial services industry, which each present opportunities for banks and other industry participants to develop or invest in technology solutions that can improve profitability, enhance customer experience, and reduce compliance costs. Through the initiatives discussed below, federal regulators are developing collaborative frameworks through which stakeholders can seek guidance and approval from their regulators, or prospective client's regulators, on the permissibility or safety and soundness of a particular technology or product. With a thoughtful approach, industry participants can work together with regulators to implement meaningful technology developments in the banking industry.

I. Federal Innovation Initiatives at a Glance

Office of the Comptroller of the Currency ("OCC")

In October 2016, the OCC announced that it would establish the Office of Innovation, which would establish a office "dedicated to responsible innovation" and implement a formal framework to improve the agency's "ability to identify, understand, and respond to financial innovation affecting the federal banking system."[1] Since its establishment, the OCC has taken a series of steps to encourage responsible innovation, including: hosting office hours throughout the country to meet one-on-one with industry participants to discuss financial technology, new products or services, bank partnerships, or other matters related to financial innovation; and started accepting and considering special purpose national bank charter applications from fintech companies. And although the OCC's innovation initiative began prior to current Comptroller Otting's arrival at the agency, he has confirmed the agency's commitment to these efforts, recently stating "[t]he OCC is committed to encouraging innovation through our supervisory approach and engagement with banks and thrifts, fintech companies, and others interested in innovation to ensure the safe, sound, and fair operation of the federal banking system."[2]

Federal Deposit Insurance Corporation ("FDIC")

In late 2018, Chairman Jelena McWilliams began discussing the FDIC's own innovation initiative and signaled that the FDIC, too, would establish an Office of Innovation. As recently as January 2019, Chairman McWilliams indicated that the FDIC is partnering with banks to understand how they are innovating, promoting technological development at community banks which may have limited funding for research and development, and analyzing policy changes that may be needed to encourage innovation. Chairman McWilliams stated, "[r]ather than play 'catch up' with technological advances, the FDIC's goal is to stay on the forefront of changes through increased collaboration and partnership with the industry."[3]

The Board of Governors of the Federal Reserve System ("FRB")

Although the FRB has not proposed an official office to focus solely on innovation or technology, it has signaled that it is welcome to responsible innovation in the industry. In November 2018, Governor Lael Brainard delivered remarks on artificial intelligence ("AI") in financial services and stated that "[r]egulation and supervision need to be thoughtfully designed so that they ensure risks are appropriately mitigated but do not stand in the way of responsible innovations that might expand access and convenience for consumers and small businesses or bring greater efficiency, risk detection, and accuracy."[4] Governor Brainard concluded his remarks by welcoming discussions with banks and other financial services firms on how existing laws, regulations, guidance, and policy interests may intersect with these new approaches.

II. A Focus on Innovation in Bank Secrecy Act and Anti-Money Laundering ("BSA/AML") Compliance

In recognition that innovation has particularly significant potential to augment or enhance aspects of a banks' BSA/AML compliance programs, on December 3, 2018, the Agencies issued a Joint Statement on Innovative Efforts to Combat Money Laundering and Terrorist Financing, which seeks "to encourage banks to consider, evaluate, and, where appropriate, responsibly implement innovative approaches to meet their [BSA/AML] compliance obligations, in order to further strengthen the financial system against illicit financial activity." Consistent with the initiatives discussed above, the Joint Statement represents the Agencies' willingness to engage with banks, as well as the private sector and other interested persons generally, to develop fintech solutions and other innovative approaches of using existing tools or adopting new technologies to enhance the effectiveness and efficiency of banks' BSA/AML compliance programs.

A critical aspect of the Joint Statement is the discussion of the types of BSA/AML innovation that will *not* be subject to regulatory criticism:

- Pilot programs in and of themselves should not subject banks to supervisory criticism even if the pilot programs ultimately prove unsuccessful;
- Pilot programs that expose gaps in a bank's current BSA/AML compliance program will not necessarily result in supervisory action with respect to that program;
- When banks test or implement artificial intelligence-based transaction monitoring systems and identify suspicious activity that would not otherwise have been identified under existing processes, the Agencies will not automatically assume that the banks' existing processes are deficient; and
- The implementation of innovative approaches in banks' BSA/AML compliance programs will not result in additional regulatory expectations.

These statements are supportive of innovation and should provide some comfort to banks that are considering whether to explore implementing new technology into their existing BSA/AML compliance programs. However, banks should not mistake these statements for a lessening of banks' current obligations and expectations. Indeed, the Joint Statement provides that "banks must continue to meet their BSA/AML compliance obligations, as well as ensure the ongoing safety and soundness of the bank, when developing pilot programs and other innovative approaches." To assure banks remain compliant throughout these processes, they should consider a number of key issues. For example, banks or technology service providers should:

- Test new programs and processes in parallel with its existing controls until the bank and its regulators gain assurance that transitioning to the new platform would not jeopardize the bank's compliance with its BSA/AML obligations.
- Thoughtfully develop a policy governing the testing of each new system that explicitly addresses how information generated through such new system will be incorporated into existing program components, if at all.
- Discuss with technology developers what historical data may be needed to test and implement new technologies, such as AI transaction monitoring systems, and whether alternative approaches are available to avoid creating new compliance concerns.
- Assess how new technologies may be governed by existing regulatory policies and expectations, such the FRB's Guidance on Managing Outsourcing Risk[5] or the OCC's Risk Management Guidance on Third-Party Relationships.[6]

The Joint Statement also identifies that FinCEN has an existing process for vetting particularly novel or impactful technologies. Under existing FinCEN regulations,[7] FinCEN is authorized to exempt a bank from certain BSA/AML regulatory requirements and, in the context of innovation, exceptive relief could provide a bank with needed flexibility and be the key to introducing technology that may not otherwise fit within the existing statutes and regulations.

III. Conclusion

In light of these regulatory initiatives and pronouncements, the time has never been better to explore, develop, and invest in technologies that have the potential to separate innovative banks from their competitors. The collaborative frameworks offered by federal regulators should be welcomed by the industry as a realistic means of developing technology in a safe and sound manner and in a way that limits the likelihood of post-implementation criticism.

ENDNOTES:

[1]*OCC Issues Responsible Innovation Framework*, NR 2016-135 (Oct. 26, 2016).

[2]*Agencies Issue a Joint Statement on Innovative Industry Approaches*, NR 2018-130 (Dec. 3, 2018).

[3]Remarks by Chairman Jelena McWilliams, "Banking on the American Dream," Florida Bankers Association Leadership Dinner, (Jan. 31, 2019).

[4]Remarks by Governor Lael Brainard, "What Are We Learning about Artificial Intelligence in Financial Services?," Federal Reserve Bank of Philadelphia (Nov. 13, 2018).

[5]SR 13-19/CA13-21 (Dec. 5, 2013).

[6]OCC 2013-29 (Oct. 30, 2013).

[7]31 C.F.R. § 1010.970.