JAVELIN

How the Comptroller Aims to Accelerate ‘Responsible Innovation’

01 April 2016 By: Mark Schwanhausser

Did you hear the one about the banking regulator that wants to help the banking and fintech industry innovate faster and smarter?

Let’s get the cheap chuckle out of your system. The straight truth is the U.S. Comptroller of the Currency laid out eight guiding principles for “responsible innovation” Thursday that show how it aims to more effectively work with banks and non-banks toward the goal of improving and broadening access to financial services for consumers without undermining security and the soundness of the financial system.

This effort is newsworthy because the OCC is acknowledging that it must overcome its institutional resistance to change and innovation – no small feat. But it also is a sign that regulator understands its critical responsibility to referee the daily collision between two well-meaning industries – bankers and fintech entrepreneurs in places like Silicon Valley – that often can’t decide whether they are allies or rivals, or that expediently partner up in ways that can disadvantage some Americans.

I consider this a must-read government document, along with the Consumer Financial Protection Bureau’s work to define and measure “financial well-being.” Each agency has sent clear signals to players in the financial industry about how their efforts will be judged.

The Comptroller’s eight principles are:

1. Support responsible innovation.
2. Foster an internal culture receptive to responsive innovation.
3. Leverage agency experience and expertise.
4. Encourage responsible innovation that provides fair access to financial services and fair treatment of consumers.
5. Further safe and sound operations through effective risk management.
6. Encourage banks of all sizes to integrate responsible innovation into their strategic planning.
7. Promote ongoing dialogue through formal outreach.
8. Collaborate with other regulators.

Here are some takeaways for a few of these principles.

Support responsible innovation. The Comptroller proposed three ideas to improve a review process that suffers from “inconsistencies and inefficiencies.” That includes creating either a centralized office to oversee innovation issues, or a less formal approach that would give authority to an existing unit within the agency. Another idea is to make it easier for banks to test products and services on a small scale by giving FIs a safe harbor if they bend a few rules along the way. Clearly, these approaches raise concerns about bureaucracy and oversight, and the fairness of experimenting with consumers – but they represent an effort to compromise and move forward faster for the greater good.

Foster an internal culture that is receptive to responsible innovation. The Comptroller is acknowledging its workforce, structure, and culture can inhibit change. There’s a “low risk tolerance” for innovation, the “deliberate and extended vetting process” can be like walking in cement sneakers, and many workers are unaware of trends and what’s new out there. Cultural shifts like this are far easier to talk about than to solve, which adds to argument for setting up a centralized innovation office or designating units of smart examiners who know individual FIs intimately.

Encourage responsible innovation that provides fair access to financial services and fair treatment of consumers. This goal cannot be unstated. At the end of the day, regulators serve the public good, and that means ensuring that the full spectrum of Americans has access to innovative financial services, not just the ones that bankers and entrepreneurs want to cherry-pick. No doubt this will sometimes frustrate both camps.

Further safe and sound operations through effective risk management. The Comptroller shined spotlights on cyber risk and risk to the financial system, and both are bedrock needs. Cyber risk is particularly relevant to the timely debate over data aggregation, which is fundamentally flawed because it relies on asking consumers to share passwords. Financial risk is particularly relevant to the growth of alternative lenders, which are making loans based on credit-scoring algorithms that have never been tested in a down market. My bet is that many startups will gripe that the Comptroller is institutionally biased against innovation, while others will consider it a sign of prudence to minimize cyber and financial risks.

Encourage banks of all sizes to integrate responsible innovation into their strategic planning. The Comptroller wants banks to be innovative – but not in a faddish way. Look for the regulator to press banks for evidence that innovative initiatives fit into strategic plans, don't create undue risks, are based on realistic financial projections, are properly staffed and supported with budget and technology -- and that "exit strategies" are in place.

Collaborate with other agencies. Few things are as tangled as the banking industry's regulatory web, and that makes it difficult for agencies to work together. This is another institutional change that will be difficult to pull off. But the Comptroller's aim is to set up regular channels for sharing information among agencies overseeing financial innovation. That effort rightfully will to start with the Consumer Financial Protection Bureau.

Do you want to have a say about this? The Comptroller invites you to send public comment to *innovation@occ.treas.gov* through May 31, and it will stage a forum in Washington, D.C., on June 23.
