

Acting Comptroller of the Currency Michael J. Hsu
Remarks before the Texas Bankers Association
“Community Banking, Digitalization, and the OCC”
September 1, 2022

I am honored to be here today to speak to you at this Texas Bankers’ Association meeting. Although I was able to address you virtually at the last meeting, I could tell from the lively banter that I was missing out on a lot by not being there in person.

I wanted to come to Dallas today to speak with you about the critical importance of community banks to local economies, to the banking industry, and to the OCC. I also want to talk about the digitalization challenges you face and how we might be able to convert those challenges into strategic opportunities.

The Importance of Community Banks to the Economy and to the Banking Industry

Community banks nationwide employ almost half a million people.¹ You excel at relationship banking—meeting people where they are and providing valued banking services to rural communities, communities of color, small business owners, first-time home buyers, and “niche” local markets across the country. Because you take the time and make the effort to develop strong relationships with your customers, you are able to offer personalized financial services tailored to individual needs. Many of these needs are overlooked by your larger competitors. For example, nearly 80 percent of all loans to farmers or secured by farmland are held on balance sheet by community banks.² Community banks hold at least two-thirds of the

¹ As of June 30, 2022, community banks employ 472,501 people. Data from Reports of Condition and Income (June 30, 2022).

² Data from Reports of Condition and Income (June 30, 2022).

deposits in more than 50 percent of all counties.³ You are essential to the economy and provide much-needed financial services across the country.

During the pandemic, we learned a lot about the importance of community banks and your role in getting relief funds into the hands of small business owners nationwide. On June 30, 2020, community banks held 41 percent or \$198 billion of the market of Paycheck Protection Program (PPP) loans.⁴ Your outsized participation and support was achieved with minimal guidance and without established processes. You were driven by your determination to meet your customers' needs, and you succeeded through long hours, hustle, and a capacity to adapt. Your customers are not likely to forget how you stepped up in their time of need.

Beyond offering financial services, community banks are also known for investing in and sponsoring local projects, teams, and events. The baseball player wearing your community bank jersey is more than just a feel-good picture, it reflects the intimate relationship your bank has with your neighbors and your community. And, it is an illustration of the unique support that community banks provide to their local economies.

The Importance of Community Banks to the OCC

The OCC strongly supports a diverse banking industry, in which community banks play a vital role. Over 85 percent of the charters that the OCC supervises are community banks, totaling almost 900 individual institutions.⁵ Community bank business models are as diverse as the communities served. Preserving that diversity is important to us.

³ Data from FDIC Summary of Deposits (June 30, 2021).

⁴ Data from Reports of Condition and Income (June 30, 2020).

⁵ As of August 2, 2022, the OCC supervises 897 community banks, excluding trust-only charters. There are 661 national banks and 236 federal savings associations.

Community banks are at a turning point. You are faced with emerging risks and challenges from digitalization, consumer compliance, cybersecurity, employee retention, and succession planning. With each challenge, however, lie significant opportunities. The shared task is to help address the challenges while seizing the opportunities. It is a task that the OCC fully embraces.

Specifically, the OCC is moving strategically to support community banks in five areas: (1) assessments, (2) de novo licensing, (3) risk-based supervision, (4) local presence and national perspective, and (5) regulation.

Assessments—The OCC is proactively working to close the pricing differential between state and federal charter assessments. In 2019, 2020, and 2021, the OCC identified ways to operate more efficiently and passed those savings along to banks by lowering assessments by more than 23 percent over the course of those three years. Today, I am proud to announce additional assessment reductions. Effective March 2023, the OCC will make a 40 percent reduction in assessments for a bank’s first \$200 million in assets and a 20 percent reduction for bank assets between \$200 million and \$20 billion. This recalibration will result in a \$41.3 million⁶ reduction in assessments for community banks in 2023. The purpose of this adjustment is to level the playing field with the cost of supervision compared to state community bank charters. The recalibration will not reduce the quality of OCC supervision or the resources available to community banks. I am hopeful that this reduction will provide community banks

⁶ This is the OCC’s estimate of the annual reduction in assessments for community banks (covering two semi-annual assessment cycles). In the same period, the OCC estimates that midsize banks will see an assessment reduction of \$11.1 million and large banks will see an assessment reduction of \$18.8 million.

with extra breathing space and capacity to invest and seize opportunities related to digitalization, compliance, cybersecurity, and personnel.

De novos—A healthy community bank industry needs start-ups. De novo bank activity has been dormant for years. This needs to change. The OCC is working to streamline the licensing process for community banks, clarify the agency’s standards, and coordinate with the FDIC and Federal Reserve to minimize redundancies and support a revitalization of de novo activity.

The OCC was pleased to charter a de novo community bank minority depository institution (MDI) in Houston, Texas, in May this year.⁷ It was the first de novo MDI that the OCC has chartered since before the financial crisis. We are also actively engaged with the Mutual Savings Association Advisory Committee to understand the impediments to the chartering and formation of de novo mutual savings associations. Mutual savings associations are one of the purest forms of community banking, and de novo mutuals would be a positive sign of health for the community banking industry. Notably, we have been engaging with the FDIC on the recent de novo state non-member mutual bank application in New Hampshire to see if there are lessons we can learn for federal mutual savings associations.

Risk-based supervision—Risk-based supervision has always been a centerpiece of our examination approach at the OCC. When executed well, it is efficient, effective, and focuses regulatory attention where it is needed most. We expect our bank portfolio managers to understand all aspects of their banks’ operations and to prioritize our examination activities accordingly. Risk-based supervision allows us to allocate our time for maximum impact and

⁷ [OCC News Release 2022-59](#) (May 23,2022) announced the de novo charter to Agility Bank, NA in Houston, Texas, a women-owned and led bank.

permits us to focus on matters that are relevant to the industry based on the underlying economic cycle and peer analysis. Along with the other strategic initiatives discussed today, we are updating our approach to risk-based supervision, which should translate into tangible benefits for banks in the future.

MCBS realignment—Some of you may be aware of the realignment of our Midsize and Community Bank Supervision (MCBS) line of business.⁸ The purpose of the realignment is to strengthen our local presence and better capitalize on our national perspective as the banking industry evolves.

This is an important point that bears explanation. Federally chartered community banks have always benefited from the local expertise of OCC examiners and Assistant Deputy Comptrollers (ADC). Our supervisory field offices are led by ADCs who understand the local markets and challenges facing banks in their portfolios. The ADC is the key decision maker for our supervision of community banks. One of the greatest strengths of the OCC is that through the local supervisory office, a dedicated portfolio manager operates as the agency's primary point of contact with a bank's management and board of directors. The examiners at our supervisory offices perform ongoing supervision, through periodic monitoring, target examinations, and full-scope examinations. Our examiners gain valuable peer perspective given their portfolio view of what is going on in the banking sector and the economy, both locally and nationally. The supervisory office is available to a bank's board of directors and management to

⁸ [OCC News Release 2022-74](#) (June 24, 2022) announced changes to the OCC's Executive Committee Membership and referenced the MCBS organizational realignment.

answer questions and provide guidance. Under the realigned MCBS structure our supervisory offices will be organized by regions under a model that is scalable, adaptable, and peer/cohort-oriented. This organizational design will strengthen our local presence and enable us to better identify geographic and peer trends and share them with our supervised banks.

In addition, we want to better capitalize on the OCC's nationwide perspective, which strengthens all the charters that we supervise. We can see trends—by locale, by region, by product and service, and by bank business model—that few others can see. Because the OCC supervises such a wide range of banks, from the smallest community bank to the most complex large bank, we can put trends and developments into context, we can see innovations as they emerge, and we can be a trusted source of information and a thought leader during times of uncertainty and change. The OCC's Economics and Policy Analysis division is especially important in this regard, providing insightful analysis and producing research that informs the agency's views and policymaking. Economists also assist in supervisory and outreach activities, including for community banks, to provide important expertise and perspective to our examiners.

Regulation—Because we understand the diversity of the banking industry, we also understand why it is imperative that we clearly differentiate regulatory expectations for banks based on their size and complexity. All too often, we hear concerns from community bankers that large bank requirements should not trickle down to smaller banks and that such requirements can be excessive and tie up scarce personnel and other resources. The OCC will remain diligent in guarding against such outcomes.

Two-way communication and open and honest dialogue are critical to making this all work. The OCC continues to seek community bank feedback through outreach activities, ongoing direct discussions with each community bank that we supervise, and our two Federal

Advisory Committees: the Minority Depository Institution Advisory Committee (MDIAC) and the Mutual Savings Association Advisory Committee (MSAAC). I encourage you to join these public meetings and other OCC-hosted outreach events to share your views and hear about our priorities. We also invite you to share your ideas, concerns, and recommendations with your direct supervision points of contact: your portfolio manager, your Assistant Deputy Comptroller, and your Associate Deputy Comptroller.

Converting the Digitalization Challenge Into a Strategic Opportunity

I now want to pivot and focus on perhaps the top long-term challenge and opportunity facing the industry and bank regulators today: digitalization.

The digitalization trend has been under way for some time but has accelerated in recent years. In 2020, the FDIC’s community bank study highlighted the most common consumer-facing technologies that community banks were adopting.⁹ Those technologies included mobile and app-based banking, electronic bill payment, remote deposit capture, and online loan applications. Then COVID hit and pulled the future forward—by one estimate roughly five years of trendline digital growth took place within the first year of the pandemic.¹⁰

Digitalization is more than just converting data to digital form. It involves a move toward comprehensive use of digital technologies to compete and support evolving customer needs and expectations, especially with regards to online and mobile banking. Incorporating a thoughtful digitalization strategy within a bank’s strategic business plan can lead to more

⁹ [FDIC Community Banking Study](#) (December 2020).

¹⁰ McKinsey & Company, “[How COVID-19 has pushed companies over the technology tipping point—and transformed business forever](#)” (October 5, 2020); Forbes, “[COVID-19 Accelerated E-Commerce Growth ‘4 To 6 Years’](#)” (June 12, 2020)

efficient operations, better products and services for existing customers, and more competitive offerings for future customers.

Big picture, there are three key challenges: (1) leveling the playing field, (2) overcoming inertia, and (3) addressing the need for scale.

On the first issue, I have been an outspoken advocate of leveling the playing field between banks and nonbanks.¹¹ My experiences in the 2008 financial crisis taught me about the disastrous consequences that can result from an unlevel playing field where regulatory arbitrage and races to the bottom are allowed to fester. Under my tenure as Acting Comptroller, the OCC is requiring fintechs seeking a bank charter to be subject to the same requirements as all national banks¹² and we are engaging with our peer agencies to limit regulatory arbitrage.

On the second issue, overcoming inertia starts with clear-eyed strategic planning. A well-designed strategic plan is anchored in an objective and sober assessment of long-term trends and, for community banks, will prioritize investments in information technology, third-party relationships, and people. The building blocks of how you choose your core service provider and other third-party relationships will influence your ability to build the products and services needed to achieve your long-term goals. Success will be determined by your ability to attract and retain the next generation of customers, most of whom are digitally native. To overcome

¹¹ [OCC News Release 2021-117](#) (November 16, 2021) conveyed Acting Comptroller Hsu's speech on modernizing the financial regulatory perimeter at the Federal Reserve Bank of Philadelphia's Fifth Annual Fintech Conference.

¹² [OCC News Release 2022-4](#) (January 18, 2022) conveyed the OCC's conditional approval of applications to create SoFi Bank, National Association ("Today's decision brings SoFi, a large fintech, inside the federal bank regulatory perimeter, where it will be subject to comprehensive supervision and the full panoply of bank regulations, including the Community Reinvestment Act. This levels the playing field and will ensure that SoFi's deposit and lending activities are conducted safely and soundly, including limiting the bank's ability to engage in crypto-asset activities.").

inertia, diversity of thought within your Boards and Senior Management teams, will be critical. Inertia is also something that we, bank regulators, must overcome. I'll say more on this later.

The third issue—addressing the need for scale—is perhaps the toughest. Many community banks lack scale. The digital world, by contrast, thrives on it. To succeed digitally, community banks are going to need to find ways to *constructively achieve* scale in certain areas—for instance, by engaging with a broader range of technology firms on a broader range of tasks, by developing new ways to share information with peer banks, by exploring consortium arrangements and other novel ways to collaborate, and by considering what the cloud can offer. The key danger here is that in the search for scale, the core comparative advantage of community banks—relationship banking—gets lost. In the extreme, the search for scale can result in rent-a-charter arrangements with arbitrage-focused fintechs. I think we can all agree that strategically that path is problematic and a dead end for the industry.

A better path is to collaborate and innovate together. In 2015, the OCC published a white paper on community bank collaboration.¹³ We are exploring how to reinvigorate that effort to facilitate arrangements amongst community banks that pool resources and leverage expertise and perspective. We are also studying innovative efforts by others and considering how engagement or adoption may be helpful. The FDIC's tech sprint program, the UK Prudential Regulation Authority's new RegTech, Data and Innovation Division, and the Independent Community Bankers of America's (ICBA) ThinkTECH Accelerator are just a few examples.¹⁴ By working

¹³ [OCC News Release 2015-1](#) (January 13, 2015) conveyed an OCC white paper titled, "An Opportunity for Community Banks: Working Together Collaboratively."

¹⁴ FDIC, [Sprint Program](#); Prudential Regulation Authority, [Business Plan 2022/23](#); Independent Community Bankers of America, [ThinkTECH Accelerator](#).

together and innovating ourselves, we can encourage and support community banks in addressing scale challenges as they transition to digital.

Earlier, I noted that we, bank regulators, must also overcome inertia. Regulators, by nature, are risk averse. Change is often synonymous with risk, and we naturally have a heightened sensitivity to change. This is usually good—risk aversion is what you want in your bank regulator. This mindset can create blind spots, however. Typically, when things are unchanging, risks are lower and regulators can be less guarded. Unfortunately, this is not the case with community banks and digitalization. Regulators must recognize that banks today face two-sided risk—i.e., that there is as much risk with a *lack* of change and maintaining the status quo as there is with seeking change. Shifting to this mindset will take some work. Let me highlight three areas where progress is needed most.

The first is with third-party risk management (TPRM). Our supervisory expectations for community banks are tailored. This approach is reflected in the OCC’s 2013 TPRM guidance, our frequently asked questions (FAQs) issued in 2020, and the interagency TPRM guidance that was proposed for comment last year.¹⁵ That said, we need to better support our examiners in their interactions with community banks on this issue. Specifically, we need to improve examiners’ awareness of the unique and evolving digitalization challenges and opportunities faced by community banks and encourage open-mindedness to new and innovative approaches to meeting safety and soundness expectations, including when it comes to community banks’ third-party relationships. This is not going to be easy and will require enhanced engagement, as we

¹⁵ [OCC Bulletin 2013-29](#), “Third-Party Relationships: Risk Management Guidance” (October 30, 2013); [OCC Bulletin 2021-42](#), “Third-Party Relationships: Agencies Extend Comment Period on Proposed Interagency Guidance” (September 10, 2021).

cannot simply adopt a lighter supervisory approach and expect less from community banks. The 2021 interagency guide to community banks on conducting due diligence on fintechs is a good first step, as it provides examples of different approaches and resources that can be leveraged to deal with new fintech firms with limited histories.¹⁶ However, more work is needed, especially given the growth of banking-as-a-service arrangements, as those relationships are often complex or inverted and involve different risk considerations.

The second is with cloud adoption. In most industries, being digitally native means being “cloud first.” Banking is unlikely to be any different. There are many ways in which banks can use the cloud, and we have observed growth in banks’ direct use of cloud-based environments. In addition, we are seeing increasing indirect reliance on public cloud infrastructures through third-party supported products and services. We, as bank regulators, need to recognize the increasing risks of simply sticking with legacy technologies and arrangements. Doing nothing can be just as risky. We need to increase our engagement with banks, fintechs, and cloud providers to more fully probe and understand the benefits, and unique risks, associated with cloud usage and to provide our examiners with the tools they need to better engage in conversations with bank management teams on their cloud strategies.

The third is with our engagement with fintechs, big techs, and the cores. The OCC’s Office of Innovation, which was established in 2016, has done great work meeting with fintechs and providing training to our examiners and technical assistance to our community banks. As the fintech industry continues to grow and bank-fintech arrangements multiply, it is critical that we expand our coverage and increase our interactions with fintechs and big techs, while

¹⁶ [OCC Bulletin 2021-40](#), “Third-Party Relationships: Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks” (August 27, 2021).

strengthening our oversight of banks' relationships with third parties. By doing so and better embedding what we learn with our examiners, we can improve our supervision and our ability to help community banks transition to digital in a safe and sound manner.

In addition to making these shifts, this November the OCC's Economics division will be hosting a symposium for academic, regulatory, and other experts to discuss research that explores how the banking system, and community banks in particular, leverage technology and respond to the growth of new providers of banking services, whether competitive or cooperative. As you can see, we are bringing multiple approaches to bear on the community bank digitalization challenge. I believe meeting that challenge head on and converting it into a strategic opportunity is the clearest path to ensuring a safe and sound, thriving community banking system well into the future.

Conclusion

I believe in community banking. And I believe that the future of community banking is bright. To get there, though, we must collaborate, innovate, and think and act strategically.

Thank you for your time today. I look forward to your questions and hope that my comments inspire greater engagement and action.