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Accountability for Banks, Accountability for Regulators

Essay by

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The U.S. federal banking agencies provide critical oversight of and play a vital role in maintaining a safe and sound banking system. These roles are carefully defined and expressly limited by statute. The banking agencies' focus on the safety and soundness of individual financial institutions and the stability of the broader financial system lays a solid foundation for a robust financial services industry in the U.S. and abroad.[1]

To accomplish these goals of safety and soundness and financial stability, the banking agencies must ensure that banks are held to high standards through financial regulation and supervision. This takes many forms: bank regulators enforce robust regulatory standards to promote safety and soundness, they engage in periodic examinations of banks and their holding companies, and banks must comply with periodic regulatory reporting requirements. When necessary, regulators hold banks accountable for lapses in adherence to these standards by requiring prompt remediation of supervisory findings, or by taking enforcement actions.

Bank regulators have a great deal of independence and autonomy in the execution of these duties, and this independence serves as a strength. Independence in the Federal Reserve's bank regulatory function is designed to ensure that supervisory and regulatory decisions are driven by the goals of promoting a safe and sound financial system and safeguarding the stability of the U.S. financial system. In this context, independence also means that the Federal Reserve should not be influenced by political considerations in making policy decisions or in the drafting of regulations. Historically, the Federal

[1] The views expressed in this article are my own and do not necessarily reflect those of my colleagues on the Federal Reserve Board or the Federal Open Market Committee. It will be published in a forthcoming issue of *Starling Insights*.

Reserve's independence in bank regulation and supervision has also provided stability and consistency to regulated institutions. This is not to suggest that bank regulation should remain static in the face of change. To the contrary, the Federal Reserve's regulatory approach must be capable of addressing and adapting to new banking activities and new risks but also must be aligned with furthering our statutory objectives.

Accountability Does Not Undermine Independence

Of course, this independence in bank regulation must be accompanied by accountability, to both Congress and the American public. Accountability is no less important for bank regulators than it is for banks. Bank regulators serve an important public function, and as we have seen in the past year, the stakes are high. Bank failures and stress in the banking system pose significant risks, not only to the bank customers, depositors, and creditors of a failed bank, but also to the broader financial system, the U.S. economy, and U.S. taxpayers.

Existing law provides a number of mechanisms to ensure accountability to Congress. First, members of the Board of Governors are appointed by the President, subject to the advice and consent of the Senate. Second, the Board also regularly communicates with Congress, both through in-person testimony to relevant banking and financial services committees and by providing regular reports on key areas within the Federal Reserve's areas of responsibility, including semiannual reports on monetary policy, bank applications activity, supervision and regulation, cybersecurity and financial system resilience, and financial stability.

While this regular cadence of testimony and public reporting provides visibility into the inner workings of the Federal Reserve, not just for Congress, but also for the public, this is only one aspect of regulatory accountability.

Accountability Requires Transparency

Accountability also requires transparent policies and procedures and conducting supervision in a way that is predictable and fair. These actions demonstrate to the public and regulated institutions that the agencies hold not only those institutions but also themselves to high standards.

Transparency builds legitimacy by demonstrating that the Federal Reserve executes its responsibilities fairly across all regulated institutions. For example, the supervisory standards and expectations applied during the examination process should not vary by geography or by supervisor but should only vary by the risks presented during the examination process. Another area deserving continuous attention and improvement is in the publication of clear, appropriate, and tailored guidance. One example in which we accomplished this goal was by providing tools to help community banks estimate losses under the Current Expected Credit Loss, or CECL, accounting standard. But we owe this duty of transparency to all of our regulated institutions, and increased transparency will help to ensure that banks are being held to the same standards as their peers over time.

Transparency assists in ensuring accountability, in addition to building legitimacy and public trust. To be clear, in this context, transparency does not equate to leniency. We hold banks of all sizes to high standards, commensurate with their size and risk. Being transparent does not dilute the rigor of our regulatory standards, in fact it helps to ensure that banks are aware of these standards and expectations so that they can more effectively and efficiently work to meet them. That same transparency helps show that we regulators are holding ourselves to high standards—that we are appropriately exercising the power granted to us by Congress and have done so in a way that supports due process and fairness.

We should not be afraid to show our work in the execution of our regulatory or supervisory responsibilities.

The Fed's Responsibility for Appropriate Implementation of Supervision and Regulation

Perhaps most importantly, though, we must implement the laws that Congress has passed as they are written and not stretch that authority to venture into other areas of policymaking. As an example, consider the distinction between (1) making sure institutions are managing all of their material risks and (2) instructing banks to make certain credit allocation decisions by influencing banks to make or not make loans to certain industries. The first objective—the management of material risks—is a central function of a bank supervisor and is fundamental to safety and soundness. But it is equally clear that the second objective—influencing a bank to make certain credit allocation decisions—is not the role of a banking regulator, nor of a central bank. A broad view across the regulated banking sectors reveals a diverse ecosystem of banks, with each bank making different credit decisions in reaction to both market demand and economic conditions, but also furthering the bank's business strategy. I share the widely held view that the appropriate role of the Federal Reserve is not to make credit allocation decisions for banks.

The Fed's role as a banking supervisor is not to replace a bank's management and board of directors in adopting a banking strategy and risk appetite. Instead, it is to apply appropriate, targeted regulation and supervision, to assess whether a bank is operating in compliance with applicable laws and in a safe and sound manner. This can be a difficult balance to strike but it is something we must always keep in mind whenever the Federal Reserve uses or proposes using its regulatory or supervisory tools. Banking regulation and supervision is not the appropriate method to implement new policies that are not mandated by Congress.

We live in a time when confidence in public institutions is waning. As such, the banking agencies should strive to demonstrate beyond doubt that they execute their duties in an independent manner, focusing on statutory obligations. We should embrace holding ourselves to high standards—just as we hold banks to high standards—and do so in a way that promotes public accountability. When we identify shortcomings in our own performance, we must humbly acknowledge these shortcomings and make appropriate adjustments. Accountability promotes healthy bank regulation and supervision, just as accountability promotes a healthy banking system.