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# Bank Regulation in 2025 and Beyond


Remarks by

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Thank you for the invitation to speak to you today.[1] It is a pleasure to be with you. I always enjoy the opportunity to meet bankers from across the country to learn about the issues that are important to you. Recently, I have observed a shift in tone when I talk to bankers about the bank regulatory environment. Bankers are cautiously optimistic that we will see meaningful reform that right-sizes regulation and supervisory approach, reforms that—if executed appropriately—should help the banking system promote economic growth in a safe and sound manner. Today, I will share my views on a number of issues related to banking regulation and supervision, including the importance of tailoring, having a problem-focused approach to bank regulation and supervision, and the imperative of innovation in the banking system.

One of the unique characteristics of the U.S. banking system is the broad scope of institutions it includes and the wide range of customers and communities it serves. Given this wide variety of institutions, regulators must strive to foster a financial system that enables each and every bank, no matter its size, to thrive, supporting a vibrant economy and financial system. We must also be sensitive to emerging issues and trends that require attention, whether that be unintended consequences from capital requirements, the incentives created by our approach to regulatory applications, and to ensure legal compliance.

**Tailoring**

The approach to regulation and supervision should promote a healthy and vibrant banking system. One key element of a regulatory approach that does so, and one that I often highlight, is the use of "tailoring" in the regulatory framework. For those familiar with my philosophy on

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[1] The views expressed here are my own and are not necessarily those of my colleagues on the Federal Reserve Board or the Federal Open Market Committee.

bank regulation and supervision, my interest and focus on tailoring will come as no surprise.[2] In its most basic form, it is difficult to disagree with the virtue of regulatory and supervisory tailoring—calibrating the requirements and expectations imposed on a firm based on its size, business model, risk profile, and complexity—as a reasonable, appropriate, and responsible approach for bank regulation and supervision. In fact, tailoring is embedded in the statutory fabric of the Federal Reserve's bank regulatory responsibilities.[3]

The bank regulatory framework inherently includes significant costs—both the cost of operating the banking agencies and the cost to the banking industry of complying with regulations, the examination process, and supplying information to regulators both through formal information collections and through one-off requests. In the aggregate, these costs can ultimately affect the price and availability of credit, geographic access to banking services, and the broader economy. The cost of this framework—both to regulators and to the industry—reflects layers of policy decisions over many years. But this framework could be more effective in balancing the mandate to promote safety and soundness with the need to have a banking system that promotes economic growth.

Let's consider costs. As regulatory and supervisory demands grow, there is often parallel growth in the staff and budgets of the banking agencies. We should not only be cognizant of these costs, but we should act in a way that requires efficiency while ensuring safety and soundness. Some degree of elasticity in regulator capacity is necessary to respond to evolving economic and banking conditions, as well as emerging risks, but there must be reasonable

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[2] See, e.g., Michelle W. Bowman, "Tailoring, Fidelity to the Rule of Law, and Unintended Consequences" (speech at the Harvard Law School Faculty Club, Cambridge, MA, March 5, 2024), https://www.federalreserve.gov/newsevents/speech/files/bowman20240305a.pdf.

[3] See, Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115-174, § 401(a)(1) (amending 12 U.S.C. § 5365), 132 Stat. 1296 (2018).

constraints on banking agency growth. Expansion of the regulatory framework is not a cost-free endeavor. These costs are shouldered by taxpayers, banks, and, ultimately, bank customers.

The bank regulatory framework has great potential to provide significant benefits, including supporting an innovative banking system that enhances trust and confidence in our institutions and promotes safety and soundness. When we consider the benefits and the costs, we can institute greater efficiencies in both banking regulation and in the banking industry itself. The framework is complex, and the various elements of this framework are intended to work in a complementary way. As banks evolve—by growing larger or by engaging in new activities—tailoring can help us to quickly recalibrate requirements in light of the new risks posed by the firm.

But the regulatory framework, especially how supervisors prioritize its application to the banking industry, can pose a serious threat to a bank's viability. For example, imposing the same regulatory requirements on banks with assets of $2 billion to $2 trillion under the new rules implementing the Community Reinvestment Act demonstrated a missed opportunity to promote greater effectiveness and efficiency.[4] I question the wisdom of applying the same evaluation standards to banks within such a broad range.

Likewise, supervisory guidance can provide fertile ground to differentiate supervisory expectations under a more tailored approach. While supervisory guidance is not binding on banks as a legal matter, it can signal how regulators think about particular risks and activities, and often drives community banks to reallocate resources in a way that may not be necessary or appropriate. The Fed's guidance on third-party risk management is an example of this.

[4] See dissenting statement, "Statement on the Community Reinvestment Act Final Rule by Governor Michelle W. Bowman," news release, October 24, 2023, https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20231024.htm.

Originally, this guidance was published in a way that applied to all banks, including community banks. Yet it was acknowledged even at the time of publication that it had known shortcomings, particularly in terms of its administration and lack of clarity for community banks.[5]

Tailoring is important for all banks, but it is particularly important for community banks. There are real costs not only to banks, but to communities, when the framework is insufficiently tailored, as community banks faced with excessive regulatory burdens may be forced to raise prices or seek to merge or be acquired. These banks often reach unbanked or underbanked corners of the U.S. economy, not only in terms of the customers they serve but also in terms of their geographic footprint. We are all familiar with banking deserts and the challenges many legitimate and law-abiding businesses and consumers have in accessing basic banking services and credit. It is difficult to imagine that a system with far fewer banks would as effectively serve U.S. banking and credit needs and sufficiently support economic growth.

It is imperative that we keep the benefits of tailoring in focus as the bank regulatory framework evolves. A tailored regulatory and supervisory approach can help inform our policies on a wide range of industry issues that are likely to emerge in the coming years.

**Problem-Based Solutions**

One of the most difficult challenges on the regulatory front is prioritization, both for banks managing their businesses and for regulators deciding how to fulfill their responsibilities. At a basic level, the role of regulators is dictated by statute. Congress granted the Federal Reserve and other banking agencies broad statutory powers but has constrained how those powers may be directed through the use of statutory mandates, including to promote a safe and

[5] See "Statement on Third Party Risk Management Guidance by Governor Michelle W. Bowman," news release, June 6, 2023, https://www.federalreserve.gov/newsevents/pressreleases/bowman-statement-20230606.htm.

sound banking system, and broader U.S. financial stability. In the execution of these responsibilities, the Federal Reserve must also balance the need to act in a way that enables the banking system to serve the U.S. economy and promote economic growth. While these objectives are not incompatible, they do require us to consider tradeoffs when establishing policy.

How can regulators best meet these responsibilities? As many of you may already know, I strongly believe in a pragmatic approach to policymaking.[6] This requires us to identify the problem we are trying to solve, determine whether we are the appropriate regulator to address the problem based on our statutory mandates and authorities, and explore options for addressing the identified issue.

This approach of pragmatic problem-solving also applies to supervision, where process improvements could improve functioning. The Federal Reserve exercises its supervisory responsibilities by supervisory portfolio, with each portfolio relying on a combination of Board and Reserve Bank staff.[7] It is important that *responsibility* for supervisory decisions be paired with *accountability* for such decisions, which can be complicated depending on the different roles played by Board and Reserve Bank staffs, and as institutions change supervisory portfolios. The misalignment of responsibility and accountability detracts from effective supervision.

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[6] Michelle W. Bowman, "Approaching Policymaking Pragmatically" (remarks to the Forum Club of the Palm Beaches, West Palm Beach, FL, November 20, 2024), https://www.federalreserve.gov/newsevents/speech/files/bowman20241120a.pdf.

[7] Board of Governors of the Federal Reserve System, "Understanding Federal Reserve Supervision" ("What is the difference between what examiners do at Reserve Banks and staff do at the Board? Supervision is a function of the Board, with Reserve Banks conducting supervision under the Board's delegated authority. The Board and Reserve Bank staff both play a critical role in carrying out the function of supervision, but the role varies by the supervisory group in which a bank is designated. LISCC supervision is run by the Board, with examiners employed by the Board and the Reserve Banks. For all other programs, examinations are conducted by Reserve Bank staff, with involvement of Board staff on horizontal exercises and key decisions. For banks in supervisory groups other than LISCC, Board staff set expectations for how Reserve Bank staff conduct examinations and, in turn, conduct oversight of Reserve Bank supervision to determine how well supervision is executed."), https://www.federalreserve.gov/supervisionreg/approaches-to-bank-supervision.htm.

Our supervisory program should require strong examiner training, rely on examiner expertise in the conduct of examinations, and work in partnership with state bank supervisors. Doing so will allow us to leverage the practical experience and judgment of examination staff—characteristics that are necessary for effective supervision—while preserving the role of the Board to delegate and provide Reserve Bank oversight. Examinations cannot be just a box-checking exercise. We must rely on well-trained and experienced examiners empowered to exercise independent judgment and ask questions, which leads to stronger and more effective supervision.

As we look at the banking system, including the regulatory framework, we must focus on those issues that are most important to advancing statutory priorities. There is always the risk of misidentification and mis-prioritization, and that we fail to take appropriately robust action on key issues or focus on issues that are less material to a bank's safety and soundness. Our goal should be to develop a better filter to promote appropriate and effective prioritization.

***Treasury market functioning***

Where regulation may create or exacerbate financial stability risks, we need to take a close look at whether those risks are justified by the safety and soundness benefits of the regulation. The erosion of liquidity in U.S. Treasury markets provides a good example of unintended consequences and the need to evaluate tradeoffs in regulation. This issue is a byproduct of several important dynamics: (1) the role of large banks in the intermediation of U.S. Treasury markets, (2) the growth of "safe" assets in the banking system, and (3) the increase in leverage-based capital requirements becoming the binding capital constraint on some large banks. While regulators may not have tools to address all of these dynamics, clearly the adverse impact of leverage-based capital requirements falls within the banking regulators' scope of responsibility.

Issues with Treasury market functioning have been known for quite some time. We have seen a persistent trend of low liquidity in U.S. Treasury markets for several years, which has been noted in the Board's semiannual *Financial Stability Report*.[8] Low liquidity can create more volatility in prices, exacerbate the effects of market shocks, and can threaten market functioning. Treasury market functioning and liquidity will likely be affected by the Securities and Exchange Commission's central clearing requirement for U.S. Treasuries, which may improve market functioning. In addition, the Federal Reserve's Standing Repo Facility may also help to promote smooth functioning in the Treasury market. But there is uncertainty regarding how the volume of Treasury securities issued and outstanding, and changes to the Fed's balance sheet over time, may affect this.

We have seen Treasury markets experience stress events as recently as the September 2019 repo market stress, and the so-called "dash for cash" in March of 2020. Both of these events raised concerns about the resiliency of U.S. Treasury markets. Therefore, we should continue to actively monitor indicators of market function, particularly whether Treasury market functioning improves over time, thereby enabling it to withstand future shocks.

The banking regulators are uniquely positioned to not only analyze but also remediate components of the bank regulatory framework that may exacerbate Treasury market illiquidity. Large bank-affiliated primary dealers play an important role in the intermediation of U.S. Treasury markets. These dealers are not immune or insulated from the effect of banking

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[8] See Board of Governors of the Federal Reserve System, *Financial Stability Report* (Washington, DC, November 2024), 10-11, https://www.federalreserve.gov/publications/files/financial-stability-report-20241122.pdf.

regulation. While many factors can affect market liquidity, including interest rate volatility and Treasury market saturation, we must consider whether some of the pressure is a byproduct of bank regulation.

The Federal Reserve has previously intervened to address market stress and support Treasury market functioning, for example, by temporarily excluding Fed reserves and Treasuries from the denominator of the supplemental leverage ratio (SLR).[9] Treasury markets play a critical role in the U.S. and global financial systems, and we should take action to address the unintended consequences of bank regulation, while ensuring the framework continues to promote safety, soundness, and financial stability.[10]

Leverage ratios do not differentiate between the risk of certain asset classes or exposures, and therefore appropriately operate as a backstop to risk-based capital requirements. However, in periods of banks' balance sheet expansion—as during COVID-19 when we saw significant deposit inflows—leverage ratios can become the binding constraint on banks and their affiliates, increasing the amount of required capital based on increased balance sheet size regardless of risk. When constrained in this way, bank-affiliated primary dealers may pull back on market intermediation activities.

Where we can take proactive regulatory measures to ensure that primary dealers have adequate balance sheet capacity to intermediate Treasury markets, we should do so. This could

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9 See, e.g., Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks from the Supplementary Leverage Ratio, 85 Fed. Reg. 20,578, 20,579 (April 14, 2020), https://www.govinfo.gov/content/pkg/FR-2020-04-14/pdf/2020-07345.pdf.

10 See *Financial Stability Report*, 10–11. Board of Governors of the Federal Reserve System, "Federal Reserve Board Announces that the Temporary Change to Its Supplementary Leverage Ratio (SLR) for Bank Holding Companies Will Expire as Scheduled on March 31," news release, March 19, 2021, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210319a.htm (noting that the Board would seek comment on changes to the SLR).

include amending the leverage ratio and G-SIB surcharge regulations for the largest U.S. banks. Adopting regulatory changes to mitigate these concerns may not be sufficient to ensure market liquidity, but it would be an important step toward building resiliency in advance of future stress events. In my view, it would be better to fix the roof now, while the sun is shining, by addressing over-calibrated leverage ratio requirements, and considering the unintended consequences of any future capital reforms.

***Stress testing***

I will now turn to another area that the Board has already identified as a priority for review—stress testing. Stress testing can be an important supervisory tool, but its implementation, outcomes and process have raised significant questions and concerns about whether it is useful in identifying systemic weaknesses. In its current structure, it is an opaque test hidden from public scrutiny that is used to establish variable binding capital requirements on large banks. Our review should consider whether it is transparent and fair, and whether there are technical improvements that could enhance the reliability and credibility of the test and its results.[11]

In its current form, stress testing is likely deficient on each of these fronts. Transparency promotes fairness, as regulated entities and the public can better understand why and how our actions further our goals. When we identify areas that suffer from a lack of transparency, we should act promptly to address those concerns. On December 23 of last year, the Fed announced that it would soon seek public comment on "significant changes" to the stress testing process designed to improve transparency of the tests and reduce volatility of the resulting stress capital

[11] Michelle W. Bowman, "The Future of Stress Testing and the Stress Capital Buffer Framework" (speech at the Executive Council of the Banking Law Section of the Federal Bar Association, Washington, DC, September 10, 2024), https://www.federalreserve.gov/newsevents/speech/files/bowman20240910a.pdf.

buffers that apply to large financial institutions.[12] Given my longstanding support for revisiting the stress testing framework to promote transparency and reduce volatility, I am pleased with this development.[13]

***Fraud***

Finally, I would like to address the problem of fraud, particularly check fraud, which has grown in frequency and impact over the past several years. Fraud continues to harm banks, damaging the perceived safety of the banking system, and importantly hurting consumers who are the victims of fraudulent activity. Sometimes fraudsters target vulnerable populations, like the elderly, who are particularly susceptible to certain forms of fraud.

As I have noted in the past, efforts by regulators have been frustratingly slow to advance, and seem to have done little to address the underlying root causes of this increase in fraud. Why has this important issue failed to garner greater attention from all of the appropriate regulatory and law enforcement bodies? Different governmental agencies may share an important role in addressing this problem, but the need for a joint and coordinated solution does not excuse collective inaction.

Fraud is perhaps the most consistent issue raised when I speak with bankers. Often the concerns note frustrations with the tools available to fight fraud and frictions dealing with counterparties in investigating and addressing fraud. The costs of prevention, detection, and remediation can also be substantial, but so can the costs of navigating these issues dealing with

[12] Board of Governors of the Federal Reserve System, "Due to Evolving Legal Landscape & Changes in the Framework of Administrative Law, Federal Reserve Board Will Soon Seek Public Comment on Significant Changes to Improve Transparency of Bank Stress Tests & Reduce Volatility of Resulting Capital Requirements," news release, December 23, 2024, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20241223a.htm.

[13] Bowman, "The Future of Stress Testing."

affected bank customers. We are overdue for more assertive action to protect bank customers and the financial system.

**The Innovation Imperative**

Innovation has always been a priority for banks of all sizes and business models. Banks in the U.S. have a long history of developing and implementing new technologies, and innovation has the potential to make the banking and payment systems faster and more efficient, to bring new products and services to customers, and even to enhance safety and soundness.

Regulators must be open to innovation in the banking system. Our goal should be to build and support a clear and sensible regulatory framework that anticipates ongoing and evolving innovation—one that allows the private sector to innovate while also maintaining appropriate safeguards. We must promote innovation through transparency and open communication, including demonstrating a willingness to engage during the development process. Financial institutions should know what activities are permitted, and the supervisory and regulatory expectations that will accompany their activities. By providing clarity and consistency, we can encourage long-term business investment, while also continuing to support today's products and services. A clear regulatory framework would also empower supervisors to focus on safety and soundness, ensuring a safe and efficient banking and payment system.

Absent clearer rules of the road, we run the risk of reducing the availability of banking services. Bank regulatory policy should address the needs of the unbanked and expand the availability of banking services. It should not be used to limit or exclude access to banking services for legitimate customers and businesses in a way that is meant to further unrelated policy goals, sometimes referred to as "de-banking" or bank "de-risking." Credit decisions should not be dictated by banking regulations or supervisory messages. Ultimately, bankers are and should be responsible for their own credit allocation decisions.

Regulators must change approaches that have resulted in credit allocation decisions, research how banks are making decisions related to which customers they serve, and promote an environment that allows legitimate bank customers to obtain banking services.

New technologies and services often require novel regulatory and supervisory approaches, and we recognize that past approaches will likely not be effective. Often regulators take a "more is better" approach to regulation and guidance. Over the past several years, the banking industry has faced an onslaught of proposed and final regulations and guidance, materials that require a significant time commitment to review, to comment on, and to implement. Many times, these require changes to policies and procedures or risk-management practices.

Fundamentally though, this "more is better" approach fails to address the core criticisms, including both an overall lack of transparency, and the perception (and perhaps reality?) that regulators have been overly hostile to innovation, including banks' involvement in any capacity with digital assets, the use of artificial intelligence, and the availability of new technologies and providers to access the payment system.

As a banker, state bank commissioner, and as a Board member, I have made the case for a more open-minded approach to innovation, including by co-hosting an informational event for bankers together with three other bank commissioners on distributed ledger technology and banking innovation just prior to joining the Board.[14] We must prioritize understanding the risks

[14] See, e.g., Michelle W. Bowman, "Innovation and the Evolving Financial Landscape" (remarks at the Digital Chamber DC Blockchain Summit 2024, Washington, DC, May 15, 2024), https://www.federalreserve.gov/newsevents/speech/files/bowman20240515a.pdf.

and benefits of new technologies before developing a supervisory posture, especially when applying rules and using the "soft" power of supervision to discourage its use. Instead, we must create a supervisory and regulatory environment that facilitates reasonable and supportive approaches. The natural posture of a regulator may be to emphasize safety and soundness above all other objectives, but doing so will ultimately stifle innovation and threaten the long-term health and utility of the banking system.

**Closing Thoughts**

Thank you for the opportunity to speak with you today. The financial system is constantly evolving, and our regulatory approach must anticipate this evolution. We must return to a regulatory approach that emphasizes appropriate tailoring of regulatory requirements and supervisory expectations and take a pragmatic approach in identifying and remediating the most pressing issues. And we must encourage ongoing innovation in the banking and financial systems.