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Ask Permission, Not Forgiveness for Responsible Innovation: Acting Comptroller Hsu Discusses Tokenization and AI



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In a [speech](#) given at the American Bankers Association’s Risk and Compliance Conference on June 16th, Acting Comptroller Michael J. Hsu discussed the importance of responsible innovation in financial services, with a special focus on tokenization and artificial intelligence (“AI”).

Acting Comptroller Hsu started his comments by remarking that, “[i]n banking, the responsible approach to innovation is the better way: by progressing in tightly controlled stages where the risks can be identified, measured, and managed at each stage, by building the brakes and the engine at the same time, and by working with regulators, instead of around them. This takes discipline and time. It requires engagement by, and trust in, risk managers and compliance professionals from the get-go through every step of the process.”

Then he discussed the “promise and perils of tokenization and AI” for financial services. Tokenization, in this context, refers to the practice of using trusted blockchains to “improve settlement efficiency through tokenization of real-world assets and liabilities.” Today, there is a lag between when the terms of a transaction are agreed upon and when settlement of that transaction is deemed final. The lag occurs because multiple entities must reconcile and verify the transaction, and other steps and legal requirements must be met. For example, if a share of stock is “tokenized” (*i.e.*, represented by a block on a blockchain), then as soon as the instruction is given by the trader, the trusted blockchain solution can immediately transact and settle the trade. To this end, Acting Comptroller Hsu references that others have estimated that tokenization of real-world assets “could save 35 to 65 percent across the settlement value chain, including, for instance, cost savings of up to \$5 billion for equity-post trading.” Many questions, legal and otherwise, still need to be worked out with respect to tokenization, including defining the relationship between owning the token and the underlying real-world asset or liability, what happens when bankruptcy occurs, and what is the process

for un-tokenizing an asset or liability. But, once those legal foundations for tokenization are developed, then, Acting Comptroller Hsu commented, “tokenization innovations can be sustained and trusted over time.”

Acting Comptroller Hsu then turned to discuss the use of AI by banks, observing that, so far, their approach has been cautious. However, he identifies a palpable sense of FOMO (fear of missing out) in the banking community, especially as ChatGPT and other public AI platforms have captured the imagination of a wide variety of businesses and consumers. Indeed, he observes, “[t]he use of AI has the potential to reduce costs and increase efficiencies; improve products, services and performance; strengthen risk management and controls; and expand access to credit and other bank services.” However, Acting Comptroller Hsu notes that AI systems have outputs that are not predictable and oftentimes cannot be explained, especially as the AI system learns more and strays from its initial programming. In addition, he pointed out, “AI systems . . . present unique bias and discrimination challenges” and enable increasingly sophisticated frauds to be perpetrated by way of mimicking human communication and creating synthetic identities.

As banks grapple with these two kinds of innovation in particular, Acting Comptroller Hsu referred to OCC guidance regarding [New, Modified, or Expanded Bank Products and Services](#), as well as guidance on [Model Risk Management](#) (i.e., for algorithms) and regarding [Third-Party Risk Management](#) (which guidance has recently been updated and was covered by *Cabinet News and Views* [here](#)). Emphasizing that for these two areas of innovation in particular “asking for permission, not forgiveness” is the right approach, Acting Comptroller Hsu concluded his speech by acknowledging that regulators need to have a more responsive approach to create a path “where responsible and purposeful innovation can be brought to market and a combination of controls, culture and common sense can prevent irresponsible innovations from emerging.”
