

## Turn Signal?

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**By Andrew Karp**  
Partner | Financial Regulation

What is the direction of bank supervision and regulation under the Trump administration? As one would expect in these early days, the picture is evolving. A little over two weeks ago, the FDIC's Acting Chairman, Travis Hill, published a list of his goals for the FDIC. In part, these goals amount to a rejection of the prior Chairman's policies of tighter regulation and wariness toward innovation, which you can read more about [here](#).

Now comes the turn of Federal Reserve Governor Michelle Bowman. Her remarks of February 5, before the Kansas Bankers Association Government Relations Conference, addressed "*Bank Regulation in 2025 and Beyond*." Immediately following opening pleasantries, Governor Bowman noted that 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." While her formulation is indirect – putting the observation in the mouths of bankers – there is no mistaking that she shares the broad sentiment. All public remarks by a Governor of the Federal Reserve are important. These are especially important because Governor Bowman has been the Federal Reserve's principal contrarian in bank regulatory and supervisory matters over the term of the last administration, and she is thought to be a prime candidate to succeed Governor Barr as the Federal Reserve's Vice Chair for Supervision.

Governor Bowman focused primarily on three areas of regulation: tailoring, using a "problem-focused" approach to regulation and supervision, and the "imperative of innovation in the banking system." Turning first to tailoring, Governor Bowman defines it as "calibrating the requirements and expectations imposed on a firm based on its size, business model, risk profile, and complexity." She notes significantly that the Economic Growth, Regulatory Relief, and Consumer Protection Act requires the Federal Reserve to incorporate tailoring in certain regulatory and supervisory circumstances. Then, she states the underlying rationale for tailoring. Applying a system meant to oversee a \$2 trillion asset-size bank to a \$2 billion asset-size bank can, for example, impede efficiency and effectiveness of both supervision and business operations in the smaller, generally less-complex bank. This leads her to "question the wisdom of applying the same . . . standards to banks within such a broad range" and to conclude that "it is imperative that we keep the benefits of tailoring in focus as the bank regulatory framework evolves."

Next, Governor Bowman describes a "problem-focused" approach to supervision and regulation as a means of determining regulatory and supervisory priorities. This approach "requires [supervisors] 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." Her statement of the methodology responds to two recent criticisms of the Federal Reserve's, and the other U.S. banking agencies', recent supervision experiences. The criticisms are that supervisors' focus on the wrong risks, when the real risks were clear, contributed to the spate of bank failures in the Spring of 2023, and, similarly, the consistent expansion of supervisory scope can defeat supervision efforts to address true, material risks. As a solution, Governor Bowman suggests emphasizing the identification and enforcement of concepts of responsibility and accountability for supervisory conduct, while acknowledging those tasks can be complex in our system of multiple, often overlapping, bank supervisory regimes. She concludes that "[o]ur goal should be to develop a better filter to promote appropriate and effective prioritization." One expects that such a filter would involve tailoring, among other considerations.

Just as Acting Chairman Hill's goals for the FDIC highlight the importance of innovation in the market for financial services, so do Governor Bowman's remarks. She states quite clearly that "[r]egulators must be open to innovation in the banking system." Toward that end, regulators "must promote innovation through transparency and open communication, including demonstrating a willingness to engage during the development process . . ." and "[f]inancial institutions should know what activities are permitted, and the supervisory and regulatory expectations that will accompany their activities." This may require substantial changes in the current supervisory approach. As she puts it,

“[t]he 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.” It will not be lost on readers that Governor Bowman delivered these remarks on the same day as the Senate Committee on Banking, Housing and Urban Affairs held a hearing covering, among other topics, supervisory discouragement of digital innovation, and that the FDIC released previously confidential documents purporting to show that the FDIC consistently declined to engage substantively with banks in digital innovation matters.

Governor Bowman also spoke about three other matters of the moment. With respect to the operation of the Treasury market, she noted that an erosion in liquidity is in part an unintended result of “the growth of ‘safe’ assets in the banking system [as a result of recent liquidity rules], and . . . the increase in leverage-based capital requirements becoming the binding capital constraint on some large banks.” She suggested a cure could involve amending the leverage ratio and G-SIB surcharge regulations for the largest U.S. banks. Focusing then on stress testing, Governor Bowman emphasized her support for the Federal Reserve’s recent announcement “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 buffers that apply to large financial institutions.” Finally, Governor Bowman expressed some frustration with supervisors’ failure to prioritize addressing fraud, particularly check fraud. She observed that “[f]raud is perhaps the most consistent issue raised when I speak with bankers” and said that supervisors “are overdue for more assertive action to protect bank customers and the financial system.”