WRITTEN TESTIMONY

FROM THE

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TO THE

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OF THE

U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES

LITTLE ROCK, ARKANSAS FIELD HEARING ON

"CONNECTING COMMUNITIES: BUILDING INNOVATION ECOSYSTEMS ACROSS AMERICA"

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9 A.M.

I. Introduction

My name is Susannah Marshall, and I serve as the Bank Commissioner for the Arkansas State Bank Department and the Securities Commissioner for the Arkansas Securities Department. I am also very involved with the Conference of State Bank Supervisors (CSBS), the nationwide organization of banking and financial services regulators from all 50 states, the District of Columbia, Guam, Puerto Rico, American Samoa and the U.S. Virgin Islands. I currently serve on the CSBS Board of Directors, the CSBS Fintech and Innovation Steering Group, and the State Liaison Committee of the Federal Financial Institutions Examination Council among other roles.

I would like to thank the House Financial Services Subcommittee on Digital Assets, Financial Technology and Inclusion for convening this important hearing entitled, "Connecting Communities: Building Innovation Ecosystems Across America." It is a wonderful opportunity to showcase the great work we're doing across our state to provide a strong financial sector for Arkansans.

The United States benefits from a diverse array of bank and nonbank entities providing financial services. These companies operate in a regulated environment defined by federal and state laws, with state regulators performing robust, responsive and tailored oversight of each of these company types. State regulators charter and supervise 79% of all U.S. banks and are the primary regulators of a diverse range of nonbank financial services providers, including mortgage lenders, money transmitters and consumer lenders.

As a state regulator, I have a unique vantage point to both the bank and nonbank industries. Today, I want to focus on the importance of innovation and technology in these sectors. It is also imperative that we as regulators identify, understand and address potential challenges that technological innovation may create in order to appropriately and effectively oversee our regulated entities.

I have seen the value of innovation first-hand. Arkansas is home to 81 commercial banks and a federal savings bank, 89% of which are state-chartered banks. My agency has made financial innovation in our institutions a topic for discussion, and we strongly encourage our regulated entities to engage in opportunities to explore and adopt innovative technology in a strategic, safe and thoughtful manner. State regulators understand the important role technology plays in banks' abilities to provide excellent products and services and meet the needs and demands of all customers, including both businesses and individuals.

I appreciate the opportunity to share today how states, particularly my state of Arkansas, encourage firms to foster creativity, experimentation, and diversification of products and services. This environment of responsible innovation enhances local economic development, market competition and safety for consumers.

Specifically, this testimony will address:

- Why the state regulatory framework is a critical feature of our U.S. financial system which provides strong consumer protections.
- How state regulation and authority enable innovation and encourage business model flexibility.
- Regulators focus on oversight with evolution in financial services.
- How community banks view technology partnerships.

II. The State Regulatory Framework is a Critical Feature of the U.S. Financial System

States solve problems and provide for the well-being of their citizens in ways that best serve local needs. In recent years, the growth of innovative companies, activities, products and services in the United States has been staggering; however, it is important to note that technological innovation didn't start five or even ten years ago. It is a legacy component of our financial services industry and will likely continue to progress at a rapid pace.

The state financial regulatory system provides the foundation for this innovation. State regulators oversee a diverse ecosystem of banks and nonbank financial services companies that provide consumers and businesses with an abundance of choice, flexibility, and innovative and competitive products and services. We seek to promote safe and sound financial services as well as strong consumer protection provisions for the public. States are the laboratories of innovation which has led to a plethora of financial technologies that are widely used today, from checking accounts to online lending to robust mobile banking functions, as well as a host of other tools and solutions.

States can be nimble and work to evaluate many of the impacts and any possible regulatory responses of emerging technologies to see what works for their local economies and their regulated entities. This nimbleness is because of our local presence and our knowledge of the possible effects of policy changes and policy direction within our states. Our local knowledge of, and direct relationships with, financial services firms are two of the great strengths of state supervision. Consumer harm and market irregularities can be difficult to recognize from afar in Washington, D.C., but are obvious when you see them first-hand at the local level.

State Regulation Protects Consumers

State regulators are the "boots on the ground," protecting consumers from companies that run afoul of or seek to circumvent state law. Their approach to consumer protection is strong and effective. State regulators are closer to the consumer and are locally accountable, a dynamic that greatly benefits consumers in need of regulatory assistance. When state regulators receive a consumer complaint, they work directly with consumers and companies to address and resolve the issue. We've seen firsthand that when the costs historically associated with financial services are reduced by technology, products can be cheaper and delivery can be faster, but the potential for consumer harm remains – and can be exacerbated by the speed of transactions. As regulators, our job is to see through the novelty to understand the underlying activity and corresponding risks and benefits.

III. State Regulation Supports Emerging Financial Technologies

Technology has sparked and accelerated significant changes in the financial services industry. As incubators of innovation, states have experience with developing regulatory approaches for emerging financial services. State regulators, and specifically bank regulators, have a deep knowledge, awareness and understanding of the institutions we regulate. Further, many states maintain an active dialogue with fintechs, inviting companies to discuss emerging issues with regulators and providing a forum for banks and fintechs to discuss potential partnerships. Each state banking department has an innovation point-of-contact to help simplify the licensing process for fintechs should they meet the requirements to be a licensed firm. However, many fintechs may not operate as a stand-alone, licensed fintech firm, but more specifically as a technology provider that seeks to partner with a depository institution to enhance a firm's existing products and services.

As an example, the Arkansas State Bank Department, at the request of our banks, has joined in direct conversations with the bank and a fintech firm which the bank is evaluating for future business opportunities and partnerships. We wholly believe these early, introductory conversations are impactful and yield positive results for all parties and we actively encourage that type of collaboration.

State regulators across the country are holding techsprint events, where developers, financial services companies and academics collaborate on ways to develop and advance innovative products and services, with regulators providing critical feedback on compliance issues. We provide our expertise at similar programs such as the Venture Center's partnership with the FIS Fintech Accelerator program hosted here in Little Rock, Georgia Tech's Financial Services Innovation Lab in Atlanta, and others.

I would like to share a personal experience with the Venture Center. I remember my first invitation to visit the newly formed organization. This was at the early stages of industry discussions regarding fintechs, innovation hubs and the next generation of advancements in financial services. A very different environment compared to today's current era of financial technology firms and committees and working groups at the national level centered on this industry. That first two-hour meeting turned into an important connection and relationship with the Venture Center, which has provided a wonderful education and introduction to the world of innovation, technology and entrepreneurship. The Venture Center continues to demonstrate how technology partnerships can make both traditional and innovative products and services available to customers and end users, as traditional financial institutions of all sizes partner with new technology providers. These partnerships are key to the future of our financial services industry and specifically the banking industry.

In 2022, the Venture Center hosted its first VenCent Fintech Summit which spotlighted the great work and success which is happening here in Arkansas within the fintech sector. I was honored to be a part of the agenda and team members from the Arkansas State Bank Department were on-hand to engage more directly with the participants and gain additional awareness of the Venture Center's programs. At this year's event, government officials, policy makers and professionals from many facets of the financial industry provided keynote remarks and participated in sessions with attendees and firms. The strong support of Arkansas' Venture Center aids in further developing this important work as parties collectively build on these partnerships and commit to a long-term future for the program.

I have had the pleasure of joining other regulators as participants in the Venture Center's early audiences, availing all of us with the opportunity to learn more about the program and its participants and affording us the ability to offer feedback, suggestions and to facilitate discussion on how these products and services may ultimately become part of an institution's portfolio. This dialogue is a crucial step for these groups as they prepare to take the next step in their journey from idea to deployment and market utilization. It is also incredibly beneficial for us as regulators to see what technology is around the corner and to provide guidance to fintech teams on developing consumer-friendly, compliant financial products and services.

I am amazed at the inventiveness of the proposals and how they are solving problems and enhancing areas in which we never thought possible for financial institutions and their customers. I am grateful that I have the opportunity to routinely visit with Venture Center leadership and discuss the future direction of the accelerator as well as learn of their continued success and the advancement of the cohort teams.

The City of Little Rock and the State of Arkansas have been leaders in technology for many years and the Venture Center is one more piece in that larger puzzle of successfully fostering innovation for the banking and business sectors. With a rich history in business development, a legacy of leadership in financial technology and a thriving financial services sector, it is no surprise that Arkansas is home to its own fintech incubator and the Venture Center.

State Bank Regulators Engage with Each Other, Industry and Consumers

State regulators work closely with other regulators, consumer advocates and the industry to ensure improvements to state regulation benefit both consumers and companies at the same time. For example, CSBS formed several advisory and working groups involving fintech industry representatives to enhance state regulator coordination and focus on risk while minimizing regulatory burden. CSBS also frequently meets with consumer advocacy groups to ensure strong state consumer protections remain front and center as states make regulatory and supervisory changes.

I've served on the CSBS Fintech and Innovation Steering Group (FISG) with state bank regulators from across the country since 2019. The FISG has historically served as an engagement point for external stakeholders on issues and industry developments related to financial services and innovation. Prior to 2019, the group was called the Emerging Payments and Innovation Task Force and produced a model regulatory framework for virtual currencies among other outputs. Since then, the FISG has hosted several industry roundtables where fintech CEOs discussed their technology with regulators from multiple states.

FISG members meet regularly to discuss fintech and other financial services innovations and their implications on bank and nonbank regulation. At each meeting we flag new activity we are seeing in our state, any outreach we have engaged in directly with fintech firms, and how we are able to showcase opportunities for discussions on bank and fintech partnerships. Recent examples include Bitcoin ATMs, lenders launching CPI-adjusted loans, the use of non-fungible tokens in real estate transactions, artificial intelligence and real time payments. Recently, FISG members shared compliance and regulatory requirements discussions with industry at recent fintech events. A key premise of this steering group is to focus on experiences and communication among state financial regulators.

IV. Regulators Focus on Oversight as Financial Services Evolve

Nearly all banks outsource core business functions like payments services and cybersecurity, and regulators at both the state and federal level are responding to these new models. The Bank Service Company Act authorizes federal regulators to examine bank service providers for potential risks. Many state bank regulators, including my agency, have the same responsibility and explicit authority under state law to oversee the same vendors.

In June of this year, the Federal Reserve, the OCC and the FDIC issued joint interagency guidance for banks managing the risks of third-party relationships, including those with fintechs. This guidance is aimed at eliminating unnecessary confusion by harmonizing supervisory views from the federal regulators on relationships with third-party vendors. This guidance is meant as a tool and resource for banks to utilize as a guide to ensure that strong and consistent messaging exists between the regulators and the industries.

Regulatory clarity is important especially as these partnerships can expose banks and customers to unique and potentially significant risks, particularly cybersecurity risk or business continuity risk. In fact, cybersecurity issues ranked as the greatest concern in the 2023 CSBS Annual Survey of Community Banks. Nearly 93% of community banks cited it as an either "extremely important" or "very important" internal risk,[1] and for good reason. Data breaches and cyber events are occurring with greater frequency, including at large sophisticated financial institutions, core service providers and prominent cloud service providers.

[1] Community Bank Survey p.9

That is why state regulators support the Bank Service Company Examination Coordination Act, which would amend the Bank Service Company Act to make state and federal supervision more efficient, consistent and effective by enabling better information sharing and exam coordination of these providers.

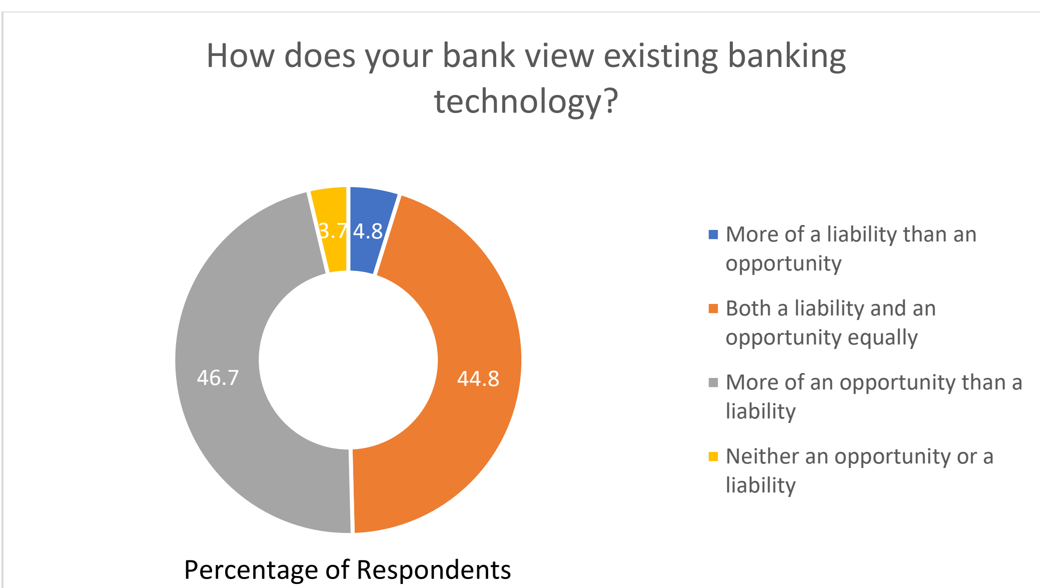
This commonsense, bipartisan legislation would provide clarity for both state and federal regulators without cost to the institutions they supervise. We appreciate that the bill passed out of the House Financial Services Committee in February 2023, and we hope to see it pass the full chamber and the Senate in the near term. By working together, state and federal regulators can better identify and highlight potential risks to financial institutions and their customers and focus on maintaining a safe and sound banking system.

V. Community Banks Share Views on Technology

Community banks have shown an increased warming to new and emerging technology in recent years; however, community banks still have concerns. I believe it is safe to say that technology is, and will continue to be, a critical component for the future of the financial services industry and it is a key point in most strategic discussions among the entities. However, it is important to note that just like our diverse landscape of financial institutions and financial services firms, not all entities will adopt innovative, emerging or novel technology programs in the same manner or at the same speed – which is certainly acceptable and appropriate.

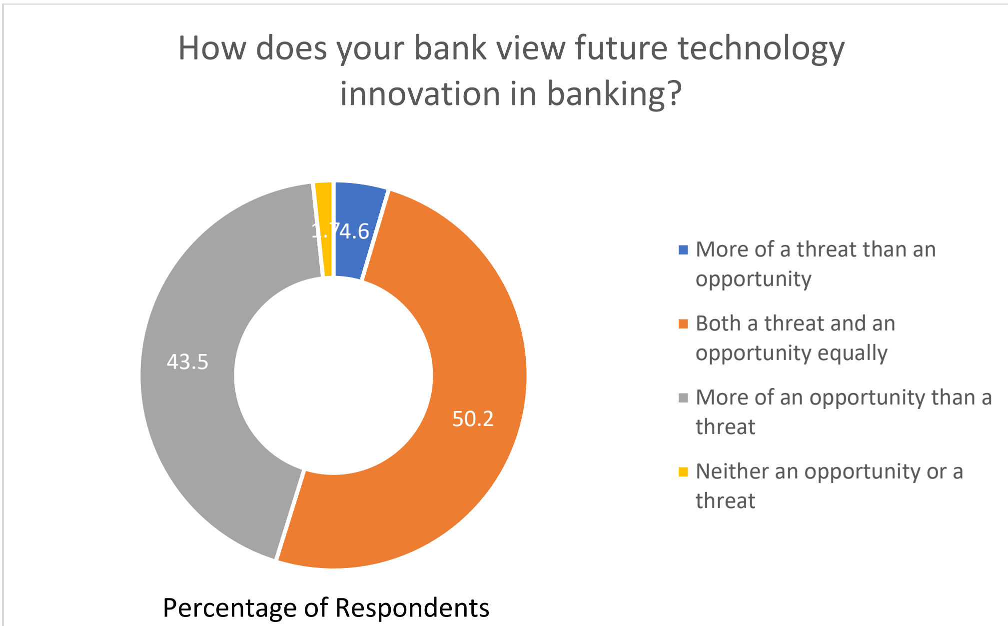
Respondents to the CSBS 2023 Annual Survey of Community Banks indicated they believe *existing* banking technologies to be more of an opportunity than a liability (47%) versus both a liability and an opportunity equally (45%) (**Chart 1**).

Chart 1



Their views on *future* banking technologies were roughly the same, with about 50% viewing future banking technologies as both a threat and an opportunity, and 44% viewing those technologies as more of an opportunity than a threat (**Chart 2**).

Chart 2



In general, while bankers identify technology as an important facet of banking, their attention remains largely focused on traditional banking rather than fintech partnerships for banking-as-a-service. Our community banks tell us that technologies focused on solutions such as mobile deposits or loan processing are extremely important tools for them and their institutions.

I think it is imperative as regulators and participants in these conversations that we work to ensure that regulators are not impediments to safe, sound and thoughtful implementation of technological advancements of products and services for our financial industry. We collectively know that the financial services arena will not remain stable or stagnant in terms of technological advancement and expectations.

Regulators, recognizing the importance of meeting both industry and consumers where they are, must ensure that our rules, guidance, and exams reflect the products and tools as they exist today and be thoughtful about this business segment in the future. State regulators are well-positioned to marry the consumer benefit of new technologies with consumer protection, but our policies and day-to-day work must take advantage of that positioning. With the majority of customer-facing technology being outsourced to third-party vendors, this work is more important than ever.[2]

[2] Community Bank Survey p.15

Conclusion

The financial services industry has been and should continue to be the foundation for innovation. It is essential that we commit to the continuation of these discussions. I believe the advancement of innovation ecosystems across this country will, and should, reach well beyond financial services and impact and benefit most every sector of our lives. Importantly, technological innovations can increase a bank's ability to reach and serve the needs of unbanked or underbanked consumers, and as we witnessed in the recent pandemic, there was an accelerated utilization of technology for increased access to financial services.

I am very proud of the important work that is happening here in Arkansas, specifically at the Venture Center, and how it can serve as a model for financial services innovation across the country.

The Arkansas State Bank Department applauds the House Financial Services Subcommittee on Digital Assets, Financial Technology and Inclusion for convening this important hearing on the need for a regulatory structure that encourages innovation in banking while ensuring financial stability and consumer protection. We in Arkansas, as well as state regulatory agencies across the country, stand ready to work with Congress as partners in ensuring a strong financial system that works for our institutions and communities.