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Statement by

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before the

Subcommittee on Digital Assets, Financial Technology, and Artificial Intelligence

of the

Committee on Financial Services

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Chairman Steil, Ranking Member Lynch, and other members of the subcommittee, thank you for the opportunity to testify on the Federal Reserve Board's (Board) work on financial sector innovation within the Division of Supervision and Regulation.

The Federal Reserve's Division of Supervision and Regulation is committed to facilitating innovation in the financial sector. Responsible innovation can improve the customer experience, expand product offerings, lower costs, increase credit availability, and enhance efficiencies for banks, businesses, and consumers alike while more generally supporting economic growth. Prudent innovation at banks also has the potential to enhance safety and soundness by enabling better risk detection and mitigation. Perhaps most importantly, responsible innovation can enable banks to better meet the evolving needs of their customers and deter the migration of financial activity into the less regulated nonbank sector. For those reasons, banks, regulators, and supervisors should be open-minded about innovation and emerging technologies.

The deployment of new products, services, and technologies is not without risk, however, and the Federal Reserve is committed to its mission of identifying and encouraging firms to mitigate any risks that threaten their safety and soundness or the stability of the U.S. financial system. Our primary duty as supervisors is to identify significant threats to safety and soundness or financial stability as early as possible and to encourage or require prompt, proportional, and effective corrective action as early as possible. Examiners are like referees in a soccer match. Banks are generally free to choose their own business models and risk profiles. But when their activities threaten safety and soundness or financial stability, examiners raise a yellow or red card in the form of a supervisory observation, matter requiring attention, enforcement action, or other supervisory action, as illustrated by figure 1 in the appendix to this statement. Innovation

that is properly regulated and supervised can lead to a more dynamic and ever-improving banking system that best serves all Americans.

One way to strike the right balance between encouraging innovation and protecting the safety and soundness of the banking system is to be more transparent and encourage feedback from the public. We do this when we propose new rules because the Administrative Procedure Act requires us to provide public notice and seek public comment about proposed new rules. But most of our supervision is hidden from public view. To receive public feedback on our supervision, we need to voluntarily lift the curtain so that more of our supervision is visible to the public, subject to protecting competitively sensitive proprietary information, confidential supervisory information, and other information that should remain confidential.

The Vice Chair for Supervision and I are deeply committed to making our supervision more transparent and publicly accountable. We demonstrated that commitment by releasing to the public in November our Statement of Supervisory Operating Principles.¹ We demonstrated it again in January when we published the operating manuals for supervising the largest and most complex banking organizations, which had previously been non-public.² We will continue to demonstrate this commitment by releasing to the public many other procedure manuals and instructions to staff that have previously been kept confidential. In this way, we will give the public more visibility into how we supervise banking organizations and solicit their feedback.

While the exact promise and peril of new technology is, by definition, unknown, there are three emerging areas that I would like to focus on today: artificial intelligence, digital assets, and

¹ See Board of Governors of the Federal Reserve System, Division of Supervision and Regulation, “Statement of Supervisory Operating Principles,” October 29, 2025, <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20251118a1.pdf>.

² See “Large Institution Supervisory Coordinating Committee (LISCC) Operating Manuals,” January 2026, <https://www.federalreserve.gov/publications/liscc-manuals.htm>.

bank-fintech partnerships. These technologies will likely be the most impactful on the banking sector in the foreseeable future.

Artificial Intelligence

Artificial intelligence (AI) has been around in various forms for some time, and Federal Reserve supervisory staff have continually monitored banks' use of it. Many variations of AI, like machine learning, have been in use for years and banks often deploy these mature, time-tested capabilities at their firms. For instance, some firms use machine learning tools in fraud detection and prevention.

The use of AI has grown markedly over the past several years at supervised banks, which are deploying both in-house and vendor products. AI can improve operational efficiencies, enhance risk management capabilities, generate new content, and provide new analytical insights. More recently, the transformative power of newer AI technologies such as generative AI and agentic AI has driven exploration across the industry. Many financial institutions have begun implementing generative AI applications to test limited functionality in areas such as document summarization and coding assistance. While uptake of these newer technologies is generally limited to low-risk applications, we expect increased adoption rates as useful applications expand to more material areas and implementation challenges are resolved.

While AI adoption promises many benefits, it is important to continually monitor risks. AI tools can present explainability, operational, model, and data challenges. The complexity and opacity of these systems can also raise bias and privacy considerations. While our supervised institutions typically have controls such as sound development practices, effective testing regimes, and human-in-the-loop systems in place to manage AI risks, financial institutions should proactively implement governance, risk management, and oversight policies as AI usage

becomes more widespread. Understanding specific use cases and methodologies is particularly important.

To facilitate the deployment of AI tools, Board and Reserve Bank supervisory staff are working to better understand the available and developing technologies. In addition to continuing to monitor banks' usage of AI, we are also exploring potential use cases to improve our own assessment and supervision of banking risk. In particular, AI tools might be useful for improving examiner training and preparation and processing large amounts of data from media, earnings calls, and public filings as part of our ongoing monitoring of financial institutions. That said, while we expect these tools to serve as a helpful and ultimately important input, judgment and decisionmaking will remain with subject matter experts.

Digital Assets

The second area I would like to highlight is digital assets. We have seen progress in the digital assets arena that could offer many benefits for both banks and their customers. For instance, payment stablecoins and tokenized deposits hold the potential to enable faster and cheaper payments. Tokenization can also potentially provide flexibility in settlement, enhanced recordkeeping and automation, and other efficiency gains.

The Federal Reserve has taken a number of steps to better enable banks to engage with digital asset technologies. We recently ensured that assessment of digital asset risks would be part of the normal course of supervision and rescinded a number of crypto-related supervisory letters.³ In December 2025, we also replaced a policy statement that placed unnecessary

³ See Board of Governors of the Federal Reserve System, "Federal Reserve Board Announces the Withdrawal of Guidance for Banks Related to their Crypto-asset and Dollar Token Activities and Related Changes to its Expectations for These Activities," press release, April 24, 2025, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20250424a.htm>, and "Federal Reserve Board Announces It Will Sunset Its Novel Activities Supervision Program and Return to Monitoring Banks' Novel Activities through the Normal Supervisory Process," press release, August 15, 2025, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20250815a.htm>.

restrictions on certain kinds of innovation with one designed to facilitate responsible innovation by Board-supervised banks.⁴ Along with our interagency colleagues, we have also clarified risk-management considerations around crypto-asset safekeeping.⁵ Looking ahead, we are considering how to provide additional clarity for banks engaged in digital asset activities. We recently clarified the capital treatment of tokenized securities, for instance.⁶ We are also coordinating with the other banking regulators as we develop regulations to implement the GENIUS Act.

Third-Party Relationships

Third, I would like to discuss our approach to third-party relationships. Bank-fintech partnerships can provide a channel for banks of all sizes to access new technologies. In particular, bank-fintech partnerships can promote a level playing field by allowing community banks to compete with larger banks that have more resources to invest in their own technology. These partnerships can also help banks quickly and cost-effectively deploy products or services into the market, along with providing banks access to new or expanded markets, revenue sources, and customers. Bank-fintech partnerships vary in terms of product offerings, making them potentially well-suited to a variety of use cases. For example, some partnerships offer traditional deposit services while others are payment or lending focused.

⁴ See Board of Governors of the Federal Reserve System, “Federal Reserve Board Withdraws 2023 Policy Statement and Issues New Policy Statement Regarding the Treatment of Certain Board-Supervised Banks that Facilitates Responsible Innovation,” press release, December 17, 2025, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20251217a.htm>.

⁵ See Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, and Office of the Comptroller of the Currency, “Agencies Issue Joint Statement on Risk-Management Considerations for Crypto-asset Safekeeping,” press release, July 14, 2025, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20250714a.htm>.

⁶ See Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, and Office of the Comptroller of the Currency, “Agencies Clarify the Capital Treatment of Tokenized Securities,” press release, March 5, 2026, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20260305a.htm>.

These partnerships can, of course, present complicated risks that require commensurate risk management and supervision. It is therefore important that banks understand their risks and legal obligations, including with respect to consumer compliance, and that we properly supervise them. For our part, the Board will continue to explore additional options to ensure banks have regulatory and supervisory clarity in their engagements with third parties.

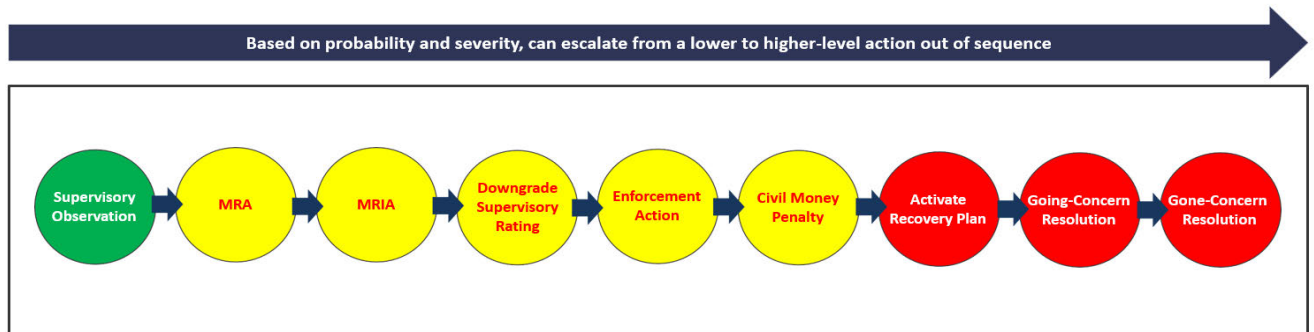
Finally, to fully see the beneficial effects of innovation on economic growth and prosperity, innovators, banks, and regulators must develop a constructive dialogue to build trust and establish a solid working foundation. Public outreach by the Federal Reserve plays an important role in our understanding of the functions of new technologies as well as the risks they may present to banks, the public, and the broader financial system. In the past year, the Board hosted a number of public conferences that included discussions about innovation and how banks intend to use new technologies.⁷ Events like these facilitate useful and necessary interactions between stakeholders and help us refine our supervision and regulation.

Thank you. I look forward to your questions.

⁷ See, for example, the Federal Reserve Board's conferences: Unleashing a Financially Inclusive Future, <https://www.federalreserve.gov/conferences/unleashing-a-financially-inclusive-future.htm> (July 15, 2025); Integrated Review of the Capital Framework for Large Banks, <https://www.federalreserve.gov/conferences/integrated-review-of-the-capital-framework-for-large-banks.htm> (July 22, 2025); the Community Bank Conference, <https://www.federalreserve.gov/conferences/community-bank-conference.htm> (October 9, 2025); and the Payments Innovation Conference, <https://www.federalreserve.gov/conferences/payments-innovation-conference.htm> (October 21, 2025).

Appendix

Figure 1: The supervisory action continuum



Note: The figure displays potential supervisory actions that can be taken to remediate supervisory observations. The actions are ordered from left to right by severity. The arrow illustrates that supervisors have the discretion to escalate remediation actions from a lower to a higher level out of sequence based on probability or severity. Some of these actions, such as activating a recovery plan, only apply to the largest and most systemic banking organizations.