Insight

Narrowing the Lens: More Focused Bank Supervision

THOMAS KINGSLEY | OCTOBER 9, 2025

Author's note: the following piece has been superseded by analysis of the Final Rule. Please see –

> *Bank Supervision: Unsafe and Unsound Final Rule*

Executive Summary

- The Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency have jointly proposed a rule seeking to restore clarity and discipline to federal bank supervision by codifying the definition of "unsafe or unsound practice," constraining the use of informal supervisory communications, and encouraging more proportionate enforcement actions.
- By formally tethering supervisory tools to material risk, the proposal seeks to reduce examiner overreach, improve consistency across institutions, and lower the compliance burden tied to nonbinding but influential findings such as Matters Requiring Attention.
- The rule's success will hinge on implementation; absent internal guardrails and cultural change within supervisory ranks, the intended shift toward risk-focused oversight may remain largely theoretical.

Introduction

On October 7, the Federal Deposit Insurance Corporation (FDIC) and the Office of the

Comptroller of the Currency (OCC) jointly proposed a rule that seeks to narrow the scope of federal bank supervision and recalibrate the use of enforcement tools to better align with risk-based threats to institutional safety and soundness. The proposal aims at a longstanding structural tension within the supervisory regime: the overextension of examiner discretion, especially in areas that touch indirectly (or not at all) on the core health of a banking institution.

If finalized, the rule would introduce three substantive reforms. First, it would formally define the term "unsafe or unsound practice," a statutory concept that underpins most supervisory and enforcement actions but has historically lacked clear boundaries. Second, it would impose new constraints on nonbinding supervisory communications – such as Matters Requiring Attention (MRAs) – that, while informal, often operate as de facto mandates. Third, it would encourage a more calibrated approach to enforcement, allowing agencies to scale their responses more proportionally to the underlying issue. Together, these changes reflect a measured effort to restore clarity and predictability to the supervisory process.

Refining the Definition of "Unsafe or Unsound Practice"

Central to the proposal is a long-overdue attempt to codify the meaning of "unsafe or unsound practice," the legal basis for a wide range of supervisory findings and enforcement actions. Despite its foundational role in the Federal Deposit Insurance Act, the term has never been formally defined in regulation. In practice, this vagueness has allowed supervisors to invoke the standard in connection with a wide array of bank behaviors, including technical violations, process shortcomings, or even subjective assessments of management quality.

The proposed definition would tether the term more firmly to practices that both deviate from sound banking operations and are likely to cause material harm to the institution. Specifically, an "unsafe or unsound practice" would be defined as one that is "reasonably expected to cause an abnormal risk of loss or damage to the institution, its depositors, or the Deposit Insurance Fund." This formulation narrows the aperture, signaling that not every procedural deficiency or compliance misstep would automatically fall within supervisory reach. It also creates a clearer threshold for when informal criticism becomes formal enforcement – an important distinction for institutions seeking to understand regulatory expectations and manage compliance costs.

Constraining the Use of Supervisory Communications

The second major reform targets a familiar but understudied aspect of modern bank regulation: the proliferation of nonbinding supervisory communications. Instruments such

as MRAs and Matters Requiring Immediate Attention (MRIAs) are not enforceable orders, but they carry significant weight in shaping institutional behavior. Over time, they have become a vehicle for regulatory guidance and examiner preference, often with limited recourse or transparency.

The agencies propose to limit these tools to circumstances in which a bank's deficiencies present a clear risk to safety and soundness or involve repeat violations of law. MRAs would be issued only when supported by a documented factual record, and agencies would be expected to distinguish clearly between binding directives and supervisory recommendations. The goal is not to eliminate informal communications but to ensure they are used sparingly and purposefully – reducing the incidence of supervisory "noise" and encouraging examiners to focus attention on substantive risk.

Of note, the rule would also promote consistency in how such communications are applied across institutions. Historically, similarly situated banks have faced very different expectations depending on examiner approach and agency region. A more formal framework could reduce this variability and support a level playing field, particularly for smaller institutions that lack the resources to challenge supervisory feedback.

Aligning Enforcement With Actual Risk

The final component of the proposal encourages a more proportionate approach to enforcement. Under current practice, there is often little distinction between enforcement actions taken for material deficiencies and those issued for relatively minor infractions. This has contributed to a compliance environment in which banks feel compelled to treat all findings – regardless of severity – with equal urgency, diverting attention and resources from areas of genuine risk.

The new rule would allow for a more graduated supervisory response, with agencies expected to match enforcement tools to the seriousness of the issue. In principle, this change could reduce the number of formal actions issued for low-level issues and restore the distinction between supervisory concern and legal violation. It also signals a shift in regulatory posture away from expansive intervention and toward a more disciplined, risk-sensitive model.

Caveats and Concerns

The promise of the proposal is real, but it carries significant implementation risks:

- **Ambiguity in Definitions**: The proposed language still leaves considerable room for interpretation, arguably fatally undermining the single purpose of the proposal.

Without further guidance, banks may continue to operate under uncertainty.

- **Supervisory Culture May Lag Rulemaking**: Codified definitions are only as strong as examiner adherence. Without robust training, oversight, and internal accountability mechanisms, supervisory behavior may remain unchanged.
- **Transitional Complexity**: Institutions will need to recalibrate policies and examiner relationships. A phased and coordinated rollout will be essential to avoid friction and confusion.
- **Potential for Uneven Application**: Large banks may benefit more quickly from the reform, while community banks could struggle with inconsistency in examiner expectations.
- **Need for Transparency and Retrospective Review**: The rule lacks a built-in mechanism for measuring effectiveness post-implementation. Regulators should commit to periodic reporting on supervisory communication volumes and enforcement trends.
- **Uninvolvement of the Federal Reserve**: This proposal would have had even greater legitimacy if the FDIC and OCC had been joined by the third key bank regulator, the Federal Reserve. Vice Chair for Supervision Michelle Bowman is working on a parallel assessment of the supervisory regime, but it is unclear why the Fed could not have simply joined this effort.

Conclusion

The FDIC and OCC's joint proposal reflects a deliberate and largely welcome attempt to clarify the scope of federal bank supervision. By anchoring enforcement to clearly defined standards, narrowing the use of informal supervisory tools, and encouraging proportional responses to risk, the agencies aim to improve both the transparency and legitimacy of the supervisory process.

Yet the ultimate effect of these reforms will depend less on rulemaking than on implementation. Regulatory culture is slow to change, and examiners will require strong internal guidance, training, and oversight to operationalize the proposed framework effectively. Without such support, there is a real risk that longstanding supervisory habits will continue unchecked, regardless of what the rule says on paper.

Still, if the agencies follow through with discipline and transparency, this proposal could mark a meaningful inflection point in the evolution of bank supervision. Institutions would gain greater certainty, regulators could focus more intently on genuine risk, and the supervisory process as a whole might become more effective, equitable, and appropriately

restrained.