



Transcription

CSBS | STATE OF THE SYSTEM | BRANDON MILHORN

Episode Transcript

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Brandon Milhorn (00:00):

I used to say I want my examiners to be examiners. I want them to be analysts. I want them to be thinking about the risks at an institution and how those risks can be managed and working with institutions. I don't want 'em to be chasing data, to be pulling paper. I want to focus their attention on what matters, and that's identifying and managing risk in the system.

Kyle Thomas (00:31):

You are listening to State of the System, the podcast that brings clarity and perspective to financial regulation. My guest today, Brandon Milhorn, is here to talk about another type of innovation that the state system is known for supervisory innovation. Specifically, he's going to tell us about CSBS program that's helping state supervisors tap into technology to solve some of their toughest challenges. Brandon is the president and CEO of CSBS. But before joining CSBS, he held senior roles at the FDIC, including chief of staff and Deputy to Chairman, Jelena McWilliams. He also spent seven years in the private sector at Raytheon and served for more than a decade in public service as staff director and chief counsel for the Senate Committee on Homeland Security and Governmental Affairs, and as general counsel for the Senate Select Committee on Intelligence. Brandon, welcome to the show.

Brandon Milhorn (01:25):

Thanks for having me.

Kyle Thomas (01:27):

Glad you're here. So CSBS provides a lot of support for state supervisors, whether that's policy, work coordination, convening technology, some of it's behind the scenes, some of it's in front of the scenes. The Catalyst initiative kind of as I see it, and as I understand it, is one of those in front of the scenes. It's a very public facing initiative and it's kind of a centralizing force. In other words, a place where we can bring and identify the best solutions that work for the most or the majority of the states on a number of different supervisory challenges at a very high level. Can you talk about what the Catalyst initiative is to



you? What I got right in my description there, and then maybe we'll dig into the details on each of the initiatives under the umbrella.

Brandon Milhorn (02:11):

Yeah, absolutely. CSBS exists to make state financial services supervision more efficient, more effective, and more coordinated. Now, our roots are really in more of the policy and training and partnerships, particularly with our federal supervision partners, but also among the states. That's where our roots are in that policy training and partnerships. But as the industry has evolved, just like everyone else, technology has become more and more important to our work. As institutions become larger and more complex and more data-driven, our supervisors and their examiners have to be able to confront and analyze mounds and mounds of data. Technology is a key enabler in this space, and that's why I love the Catalyst initiative, because it really speaks to that primary mission. It is our mission to make supervision more efficient, more effective, more coordinated, and technology can be sort of the binding that makes all of that work more effectively. And so that's what I love about the Catalyst initiative. And look, the states have been leaders on this for years, whether we started off with the nationwide multi-state licensing system, the supervisory component of NMLS, the state examination system, Catalyst is just to me another step in the evolution of state supervision using technology to make the system better.

Kyle Thomas (03:41):

Those two systems you mentioned, NMLS and SES, that's a part of that NMLS platform. Those were some early efforts at the state level. And so what that looked like was a group of states got together, funded these initiatives and built out platforms that worked for the many. And what that did was avoid having each state have to go down that development path and build a system that was kind of in its own silo that didn't connect to the other systems. Is that right?

Brandon Milhorn (04:04):

Absolutely.

Kyle Thomas (04:05):

So is that why CSBS and the states are so uniquely positioned to do things like Catalyst or are there other advantages that kind of come with our structure that make us a good fit for something like

Brandon Milhorn (04:15):



Catalyst? Yeah, I think there are two real benefits to CSBS being the lead for the Catalyst initiative. One, it's just our ability to work across all the states to think about requirements and pain points, supervisory pain points across all our state members. And that helps us build better requirements and think more broadly about how we can help the system. But the next component of Catalyst that I think is a real enabler is the procurement flexibility at CSBS. We're just going to be able to move more quickly. We're going to be able to set requirements in a more nimble fashion and we can construct innovation challenges and demos and sort of technology shootouts in a way that it's very hard to do in if you're using state procurement authorities or

Kyle Thomas (05:10):

Federal.

Brandon Milhorn (05:11):

Yeah,

Kyle Thomas (05:12):

You have a lot of experience

Brandon Milhorn (05:13):

In the federal side certain. Certainly

Kyle Thomas (05:14):

Federal, yes. Yes. So you mentioned pain points and there's a number of different angles we can discuss, but I think it might make sense to just start with the first initiative under the Catalyst umbrella, which is I think something near and dear to your heart, which we're kind of characterizing as the bank financial data challenge. This challenge or this effort is aiming to tackle the supervisory problem of getting data from financial institutions, banks that is out of date and relatively burdensome to provide and this system hasn't changed a lot over the years. Is that right? And so can you describe what's your vision of success and what's in it for the banks, the regulators, and everybody involved in this?

Brandon Milhorn (05:55):



Sure. This is a little bit of a passion project for me, so forgive me if I go a little long. I'm a little eloquent here. Please do. Is really do enjoy this topic. When I first got to the FDIC in 2018, it was my first foray into financial services. I'd been a national security lawyer as you noted, and they started describing the way they conduct supervision primarily through quarterly call reports and then annual 12 month or 18 month exams. And we try to make that forward looking. There's forward looking supervision. We try to think about how the data that we're collecting today is going to impact the institution in the future, but necessarily it is all backwards looking. The call report data is months old by the time we get it and process it. The annual report necessarily looks back at the operations of the institution over the prior year and sort of guesses at where that institution's going to be and then waits for another quarter and another quarter and another quarter to see if that was an accurate assessment or not. It struck me when I came to the FDIC, it was a lot like we used to handle cybersecurity in the private sector around the turn of the century, the two thousands, we used to do the annual cybersecurity report

(07:17):

And you'd write a story about how your systems were secure and how these were the threats that your systems were facing. By the time you wrote that report, it was already out of date. The threats had evolved, your system had evolved, new technology had come onto the scene and it was a backwards-looking tool

(07:36):

When what we really needed was to be continuously examining the health of our systems and reevaluate our cybersecurity posture based on threats. And to me, this is the benefit that technology can bring to bank supervision for our largest institutions. We already get regular data from them, but there are 4,000 banks in the United States and some of them incredibly small. Some of them still keep their loan forms in their vaults in triplicate. There are many different types of institutions, but if we can bring the system together with a shared understanding of risk, and I think that's where technology can play a real role. If we're getting access to more regular and granular data on an institution, you can start see risk developing at that institution and you can engage with them well before the annual cycle to make sure you understand, is this part of their business model, how are they managing the risk or are there steps that we need to take to mitigate that risk? It becomes a powerful tool, not because of the exam, but because the relationship that it helps build with supervisors and their financial institutions. And that should be the goal, that conversation with institutions about risk and risk mitigation and risk management as well, right?

Kyle Thomas (09:02):

Yeah. The institution management's job of managing the risk in that institution.



Brandon Milhorn (09:06):

Yeah,

Kyle Thomas (09:07):

Our ability of assessing it. Yeah. You mentioned the kind of desire to be forward-looking, but the fact that the data is such a lag on it. Just the other day I was out in the field doing a demo with one of our members and I went to pull it down a call report for a bank, and this was October 13th and the earliest call report I could get was June 30th. Here we are 45 days later and from September's quarter, 15 days after September's quarter, and we still don't have that data yet. So it's difficult.

Brandon Milhorn (09:35):

It's incredibly difficult. And we've got examiners at institutions that are looking at this old data. My first exam that we went to at the FDIC, there were two computers sitting side by side and one had a printer and one had a scanner, and we were literally printing off information from the bank system and then scanning it into the FDIC system so we could analyze it. And this was 2019. That's the state of the art in 2019. Two computers sitting side by side, we can't make them connect. And then in March of 23, when we had the huge failures of SVB signature, the liquidity risks that were across the institution, examiners were picking up the phone and calling banks and emails

Kyle Thomas (10:24):

Like the Sunday night before Monday morning opening Bell, just see if

Brandon Milhorn (10:27):

They could open to get a sense of could they open, what was the liquidity risk? Were deposits running technology. There's got to be a better way to do this with technology. That to me is the beauty of the Catalyst initiative because if we can bridge that informational gap between the supervisors and the institution and make it an ongoing dialogue, it's a powerful tool to understand what the state is seeing as a risk, what the institution is seeing as a risk and have a conversation about it. That's what technology really enables in this space.



Kyle Thomas (11:05):

So I think it's clear from a regulator standpoint, the advantages are more timely information though not real time cleaner information, maybe more tailored or specific information to whatever the risk is at hand that they're trying to capture. What about for the industry? What do they stand to gain by something like this?

Brandon Milhorn (11:22):

Yeah, well, I mean the other benefit for the regulators I think it's important to mention is better horizontal views across the entire sector. A lot of times we think institution by institution, but we need to think about horizontal risk across the entire sector as well. And having additional data can help construct that picture more completely

Kyle Thomas (11:44):

For regulators, probably aligning the time components of those data sets. So if regulators have access to more real-time information on, say, changes in the CRE market or changes in the agriculture market, but yet the data they're getting from the institutions is 45, 60 days old, those gaps in timing make comparing or laying that information on top of one another very

Brandon Milhorn (12:04):

Difficult. I mean, just think of COVID and the impact

(12:07):

That COVID had on warehouse CRE versus hospitality and office CRE. The results were a little bit different and having some additional granularity there would help understand risk in the system. As far as benefits for institutions, I think they're twofold. One, if you're sharing information and communicating more regularly with your supervisors about risks, it makes the importance of that annual exam, that 12 or 18 month review much less important. Not because it's still required by law, but because it can be risk scoped differently if you understand the risks going into the exam. If supervisors understand how you're managing that risk across time, it makes the burden of that final exam much less costly from a time and data perspective. I also think that we can cut a significant burden from industry just putting together the call report with all the technology that's available. There's still a significant manual component to filling out and sending in your call report if we can remove some of that burden



and get the conversation focused on risk, to me that's a win for both the state supervisors and for the regulated institutions.

Kyle Thomas (13:36):

And probably one of the reasons why it's so important, but also so hard to do things like this in the United States because we have the very wide and diverse set of financial institutions. So the call report was set up to work for everybody, and there's different forms, so there's the small bank form and the larger bank forms, but at the end of the day, those reporting forms, there's really only three of them and they have to work for the biggest banks all the way down to the smallest banks. But I think what I hear you saying is that if we could leverage technology, open up these data systems and use technology to capture the right information from the right institutions, that should eliminate the kind of manual ticking and tying and the conversion and the data mapping that every single bank has to go through every quarter.

Brandon Milhorn (14:18):

Every quarter. And look, there have been efforts to try to streamline call reports and how information is reported in the context of the call report. And they've had I think over time mixed success. I think we need to think more broadly about where we want to end up 10, 20 years down the road and what technology might be able to do for us and how additional levels of granularity that we may never be able to achieve within the call report might be achievable using technology, particularly ai. When you think about going across all the liquidity risks to an institution, all the concentration risk relative to CRE, I just think there are so many benefits to how technology can help you slice and dice risk at institutions that you're never going to get to with a call report that's trying to be everything to every institution,

Kyle Thomas (15:16):

Right? So CSBS approached this effort a little differently. The old model that everybody's seen a million times is an organization and a government agency decides exactly what they want. They write it all down in a couple hundred pages and they put it out and say, build us this. Tell us what it's going to cost and we're going to pick the one that we want and then we will set forth and do it. We did that differently with the Catalyst initiative, particularly this one. We knew that they were private market participants, private vendors out there who were doing things like this, working with the banks, providing banks data about their own health and operations. So we started there and let them tell us what they thought would be the appropriate solution to this kind of broad open-ended problem that you just spent quite a bit of time describing. Why did we pick that route? Why did we go that direction versus the old RFP model?



Brandon Milhorn (16:06):

There's so many flaws with the one-off perfect system. This is my history in government procurement is intelligence defense, homeland security, broader governmental contracting issues when I was on the Homeland Security Committee and then at the FDIC. And I think the mistake that government makes a lot is we need a specific system. We need this one-off system that we're going to build and it's going to be perfect and we're we're going to list off all the requirements and it's going to do exactly what we want it to. It's going to be a magical, magical system. And you go down and you make lists and lists of requirements, but the challenge there is your one-off solution nobody else needs. You're paying for all that research and development and oh, by the way, if you're successful in developing and a lot of these projects, they just die because it can't be built.

(17:08):

If you're successful, the winning allocation for you is you get to own the o and m tail and all the cybersecurity risk associated with that system over time because you've got a one off. What I love about sort of the off the shelf model is that RD risk becomes a shared risk between government and the vendor and the entire customer base improvements are driven not just by feedback from the government, but also from private sector customers. So it cuts your r and d, it cuts your o and m because that's spread across a broader customer base. And because security has a tail that can be now spread across, again, a broader customer base, it just cuts the individual cost to the government and ultimately to the states. That's a great powerful procurement tool to buy off the shelf. Now that doesn't mean there aren't going to be some changes that need to be made, but we also make the mistake, I think sometimes in government of thinking we know all the right answers. Again, it's that long list of requirements that needs to do exactly this thing when sometimes you can't imagine what technology can do for you. And there are loads of creators out there. AI is making all of us developers in a sense, and what I feel like is a powerful tool for CSBS in the states is not to say we know the answers. It's to say, here are the problems we're trying to address world, tell me what the answer might be or have

Kyle Thomas (18:56):

You done it,

Brandon Milhorn (18:56):

Give us solutions or have you done it? That's exactly right. And so opening it up with a question and allowing the private sector and technologists across the system to provide what they think is the right



solution and then showing that to our members. We've gone through the process now. We've put out our proposal, we've gotten several in. We're going to down select and shortly we're going to ask those firms that we down select to create demos and they're going to be able to come in and show examiners what their tools can do. And that to me is a tremendously powerful procurement tool. And that's why we started with just a question, how would you address this pain point?

Kyle Thomas (19:41):

Alright, really good stuff. So we spent a lot of time talking about the one work stream under the Catalyst initiative, but we have another one. This one involves the non-banking space. The states are the sole supervisors of the mortgage and other aspects of the non-bank financial services space. Before we jump into the actual initiative though, what are some priorities of the state regulators in this non-bank space

Brandon Milhorn (20:01):

As the primary regulator of non-bank entities, mortgage, money transmission, any number of consumer facing financial products on the non-bank side? There are a couple of areas that I think are important. One, it's increasing the consistency of standards across the states. Now I love the fact that one state might have a little bit different rule that provides pockets of innovation for other states, but having a consistent focus on standards across all the states is very important from a supervisory standpoint on licensing issues, making sure that we're coordinating, asking for similar information, and that flows right into our exam work as well. Instead of conducting 50 exams for entities that are working multistate, we're trying to get down to one exam that other states can leverage or accept for purposes of their activities. So that feeds directly into what we're trying to accomplish with the nationwide multistate licensing system, which streamlines licensing across the states and the state examination system, which helps coordinate exam activities across the system. And those are sort of our primary goals, that policy consistency and that exam coordination on the multi-state side that makes our system more efficient, but also cuts compliance cost for industry. And so those are our primary goals here. But the work we're doing with Catalyst is designed to address a real pain point on the non-bank mortgage supervision. That's loan compliance review

Kyle Thomas (21:44):

Within an exam. That's a big piece of it. The reviewing of the mortgage files from a given company. These companies have gotten much larger over time. So the portfolios that states are charged with managing have grown and states have had to review more and more of those loan files and those take a lot of time. Those are difficult to review.



Brandon Milhorn (22:00):

The complexity of loan review, I was first confronted with that at the FDIC where we spend 400,000 hours every year doing loan review and we're only looking at a sample of loans in institutions and it's a risk focused sample. It's designed to be targeted, but it's still 400,000 hours. And then they described to me the complexity of the compliance reviews on some of these mortgage loans. I've heard examiners say that it takes hours to page turn even one loan. So if we can help with technology there, I think it's a tremendous opportunity.

Kyle Thomas (22:35):

Yeah, no, as a former examiner, I remember loan file flipping days on the bank side. On the bank side there's loans of all different stripes and different types and different industries, but in mortgage, mortgage files have a big regulatory advantage in that they're relatively consistent, but there's a lot of things that they have to be checked for. So that's why I'm really excited to kind of segue into this second work stream under Catalyst, which is a partnership with Mismo. And for listeners who maybe don't know, that stands for the Mortgage Industry Standards Maintenance Organization. This challenge involves leveraging a new compliance standard called the Mortgage Compliance Data Set. It's a new open standard that is essentially a file, a standard file format for compliance data to come into regulators, to come into other stakeholder groups who might have an interest in ensuring a pool of mortgages is compliant on state and federal law. So the idea here is that we'll leverage this new standard and identify technology vendors who can do something meaningful from a compliance perspective with this new standard. This is different. This hasn't really been done before. There's been efforts along these lines before, but this one's different. So can you describe how you see this and the role it will hopefully take in the supervisory process?

Brandon Milhorn (23:49):

One of the stakes that we often make, I think in government and in procurement is mandating a data standard, forcing it down regulated industry's throat, and then hoping that technology gets built that supports it. What excites me about SMO and the Mortgage Compliance Dataset challenge is this is an open standard

Kyle Thomas (24:17):

Created by industry,

Brandon Milhorn (24:18):



Created by in partnership with industry. And what we're doing is we're bringing vendors in and we're saying show regulated industry show state supervisors what you can do with the standard state supervisors. Instead of getting locked in on one vendor with one solution, let's look at multiple vendors and let's have them compete for a requirement. That competition can sometimes increase capabilities, maybe it surfaces capabilities that you didn't even know you needed. That's sort of the benefit of the tech sprint. And what I love about this, and really at the heart of it all, is the convening power of CSBS. We are going to do a kickoff the first week of December. We just launched it with SMO a few days ago. We've already got over 200 participants signed up for that, and 50% of those are from the industry. I mean, that to me speaks to the demand for this sort of solutioning. We'll have our kickoff, we'll go through those problem statements in December with industry, with vendors and with our state supervisors. And then a few months later we'll come back at the NMLS conference and have our demo day where we actually see solutions that vendors have helped build based on that feedback.

Kyle Thomas (25:41):

That's great. So baked in there is kind of a hypothesis I'm forming in my head here, so do I have this right? The hypothesis here is that if a firm can generate this new data standard, this MCD industry created, industry supported data standard, then regulators should presumably be able to use the technology to analyze that data and identify the mortgage files within a large, perhaps portfolio that could have some problem spots and then work with through their old processes to figure out was this actually a problem? Was this not a problem? And then work with the industry to solve it.

Brandon Milhorn (26:14):

Yeah, that's exactly right. It cuts down on the page flipping. I used to say, I want my examiners to be examiners. I want them to be analysts thinking. I want them to be thinking about the risks at an institution and how those risks can be managed and working with institutions of, I don't want 'em to be chasing data to be pulling paper. I don't want to be printing out on one computer and scanning into the, that's a waste of time. I want to focus their attention on what matters. And that's identifying and managing risk in the system. This is why the Catalyst initiative is so important, whether it's bank financial data or our mortgage compliance dataset Sprint with Ms. Mo, it's getting examiners the tools they need to focus on their core job, which is the identification mitigation of risk.

Kyle Thomas (27:09):

Yeah, absolutely. And for firms in the mortgage industry listening to this, I'm sure they're thinking, well, this sounds good. I'll just take that data file. I'll work with the vendor, and before anything is funded and sold, I'll have assured it's compliant and I won't have to worry about anything. If the regulators are using



the same dataset, the industry can use the same dataset. It kind of builds this virtuous cycle of compliance from the get-go.

Brandon Milhorn (27:35):

Yeah, we used to call it at the F-D-I-C-A shared understanding of risk. The supervisor turns on their dashboard, they see the risk in an individual institution, the institution has that same dashboard, understands that same viewpoint into risk. Then you're talking about the real challenges instead of just chasing data.

Kyle Thomas (27:57):

Right, right. No, this is a really exciting initiative. It'll be fun to see how things go on December 3rd, and I'm guessing between now and then we'll have another 200 folks on the list.

Brandon Milhorn (28:06):

The more

Kyle Thomas (28:07):

The merrier. That's right. That's right. Well, those are the two initiatives underway in Catalyst right now. Any Eye to the Future, what else might go under this umbrella? What other supervisory challenges do you want to see tackled through this

Brandon Milhorn (28:18):

Initiative? Oh, I mean, the sky's the limit. I think of things like B-S-A-M-L, areas where both visors and industry are having real challenges, effectively implementing that supervisory and regulatory framework, implementing it effectively. I think of things like loan review more broadly. How can we use ai? And AI really opens up possibilities across the board for us. And what I love about Catalyst, and obviously I'm invested here, but we can do this at a low cost, low cost of entry. All we're doing is asking questions. We're doing some experiments and we're learning in the process how technology can be used and implemented effectively. And so instead of investing hundreds and hundreds of thousands of dollars in tools before you even know if they'll work



Kyle Thomas (29:14):

And all the time

Brandon Milhorn (29:14):

And just hoping that it's going to work, we're going to test it and we're going to test it incrementally. It's going to cut cost of R&D, it's going to put capabilities in the hands of our examiners. I'm really excited about the possibilities of Catalyst. And what's interesting is industry is excited about it as well. Our federal partners on the banking side are calling us to talk about what the states are doing in this area. Just one more opportunity for the states to lead on innovative technology that makes supervision more efficient, more effective, and cuts the cost of compliance for industry.

Kyle Thomas (29:51):

I can't think of a better quote to end things on. Awesome. Brandon, thank you very much for being here today. Thank you. Great stuff. Alright.

(29:59):

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