

# **Supervision Matters**

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# Two perspectives on supervision

## Supervision as information production

(“Bank Supervision as Information Production”)

- Ratings reflect public data – but **examiners add non-public insight**
- **On-site exams and proximity** increase informational value
- Examiner **toughness affects risk-taking** and growth
- Supervisory **tone shifts over the cycle**

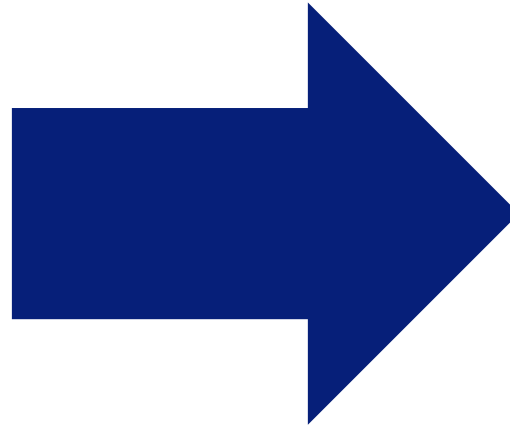
## Supervision as discipline and resolution

(“Supervising Failing Banks”)

- Supervisors **typically identify troubled banks** before failure
- Exams **accelerate loss recognition**
- Enforcement actions **constrain payouts and risk**
- Stricter supervision **increases and speeds closures**
- Earlier intervention **lowers FDIC resolution costs** – but tightens credit

# Supervision: information and discipline – and why reform matters

- Supervision **produces information** markets don't see
- That information **drives enforcement** and closure decisions
- Information and discipline **reinforce each other**



## Changes to how supervisors:

- gather information
- exercise judgment
- escalate concerns
- intervene

**will change outcomes – not just process**

*Supervision matters – what examiners see, say, and do changes bank behavior and outcomes. Current efforts to reform supervision should consider these findings*

# 1. What's changing: risk prioritization

## What's changing

- Greater emphasis on measurable financial metrics
- Reduced emphasis on qualitative findings (e.g., culture, governance, management effectiveness)
- Less focus on internal control weaknesses

## Arguments in favor of current direction

- Reduces subjectivity concerns
- Enhances transparency
- Improves consistency

## What the research suggests

- Examiner judgment adds real incremental value
- Governance and management weaknesses often show up before financial stress
- Internal control issues are early warning indicators
- Supervisory ratings contain predictive information beyond public financial metrics

*Quantitative metrics are essential – but supervisory judgment adds value*

## 2. What's changing: operating model and horizontal exams

### What's changing

- More centralization
- Fewer or narrower horizontal exams
- Streamlined exam processes

### Arguments in favor of direction

- Improves efficiency
- Reduces duplication
- Focuses on firm-specific risks

### What the research reminds us

- Horizontal exams create comparative insight across firms
- They help identify outliers early
- They detect emerging system-wide patterns

*If supervision adds value through comparison, fewer horizontals mean fewer early warnings*

### 3. What's changing: MRAs, enforcement, and escalation

#### What's changing

- Higher thresholds for MRAs
- Recalibration of enforcement triggers
- Greater emphasis on informal resolution

#### Arguments in favor of direction

- Focuses on material financial risks
- Reduces supervisory burden
- Limits perceived overreach

#### What the research shows

- Supervision is most effective when it acts early
- Delayed intervention increases failure severity
- More forceful action reduces resolution costs – but can tighten credit

*Earlier action can reduce losses – but timing and calibration matter*

## 4. What's changing: staffing

### What's changing

- Leaner supervisory teams
- Broader reductions in staffing
- Loss of institutional memory and expertise

### Arguments in favor of direction

- Efficiency
- Reduced burden
- Modernization
- Forces prioritization

### What the research suggests

- Supervision is human-capital intensive
- Examiner experience and proximity matter
- Information production depends on judgment and expertise

*Supervision isn't fully automatable. Underinvest in people, and you weaken crisis readiness*

# So what? The practitioner takeaway

- **Protect what makes supervision work**
  - ✓ Supervision **adds value** because it produces insight – not just metrics
  - ✓ If we over-mechanize supervision or hollow out field expertise, we **risk losing that edge**
- **Don't confuse consistency with effectiveness**
  - ✓ Some **variation reflects real differences** in judgment
  - ✓ The goal isn't zero discretion – it's **better judgment**
- **Tougher isn't the same as better**
  - ✓ Earlier intervention **can reduce losses** – but it can also tighten credit
  - ✓ Calibration matters
- **Don't fight the last war**
  - ✓ These papers largely reflect slower-building stress
  - ✓ The **next episode may look different** – but informed judgment will still matter
- **Lean isn't the same as ready**
  - ✓ Supervision depends on **talent and experience**
  - ✓ Efficiency should not come **at the expense of crisis readiness**

*It's not just that **supervision matters**. It's how, where, and when it matters*