William C Dudley: Welcoming remarks at the Community Bankers Conference

Remarks by Mr William C Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the Community Bankers Conference, Federal Reserve Bank of New York, New York City, 18 April 2018.

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Thank you for joining us today for our 16th Annual Community Bankers Conference. This is my last opportunity to address this fine group of community bank leaders in my role as president of the New York Fed. As always, what I have to say reflects my own views and not necessarily those of the Federal Open Market Committee (FOMC) or the Federal Reserve System.[1]

Since becoming head of the New York Fed in 2009, I have had the opportunity to watch the evolution of community banking up close. I observed the resilience of community banks at the height of the financial crisis and how your organizations managed during those turbulent times. I also have had the privilege of meeting with many of you during my regional visits, and I remain impressed with how small banks remain important pillars of economic support for their communities.

The past decade has seen significant change for your industry. There has been significant consolidation among institutions and the remaining community banks are much healthier. Back in 2009, there were 191 community banks in the Second District with an aggregate of $223 billion in total assets. In contrast, there are 135 community banks today. Despite this contraction in number, the remaining firms have continued to grow and thrive, and now have assets totaling $291 billion, which is an increase of about 30 percent. Community banks are much stronger financially today. In 2009, troubled assets were 26 percent of capital, primarily reflecting a large volume of construction lending. That ratio has declined significantly, to 8.5 percent today—demonstrating that community bank leaders have the capacity to take action, effectively work out troubled assets, and generate capital. These data tell a welcome story regarding your ability to successfully conduct business through the economic recovery.

So, where does the industry go from here and what challenges lie ahead? That is the theme of today’s conference, and I expect a robust and enlightening series of discussions from both panelists and presenters. From my perspective, there are two challenges that I would highlight: ongoing advances in technology, and interest rate risk.

First, major technological changes are compelling banks to embrace technology to better meet the needs of their customers. Today’s customer expects increased digital access, and a bank’s failure to advance technologically would be very damaging for its franchise value. But, the use of new technology comes with its own risks that require significant investment and attention—especially around cybersecurity.

Second, in today’s low interest rate environment, we have observed that some community banks have taken on more interest rate risk by increasing the maturity of their assets and the average duration of their loan portfolios. In the last rate tightening cycle, we observed that banks with larger concentrations of long-term earning assets experienced lower margins. It will be important for community banks that are very sensitive to interest rate risk to evaluate the risk management of their loan portfolios.

Finally, when I meet with community bankers, I am often asked the following question: “When will we see regulatory relief?” My simple answer is soon, I hope.

There is wide ranging consensus—across party lines and among regulators, the Federal

Reserve included—that we need to reform the regulatory requirements for small banks. As I have said, I favor regulatory relief for smaller banking organizations.[2] Their size and complexity do not pose a significant risk to the system, and they lack the scale to absorb large compliance and other regulatory costs. Given broad agreement on this issue, I am hopeful that relief will be forthcoming.

Let me conclude by saying that we continue to recognize the important role community banks play in our economy. According to a study by our colleagues at the Kansas City Fed, the U.S. banking system is unique because of its balance between a small number of large banks and thousands of community banks.[3] That balance helps serve the needs of a large and diverse U.S. economy that includes businesses of all sizes and consumers with different needs and preferences. As the U.S. economy continues to grow and expand—as I expect it will—your personalized customer service, commitment to relationship banking, and adaptability to technological advances will serve you and your communities well.

I will miss many aspects of my role at the New York Fed, particularly the opportunities I've had to interact with the community bankers in our district. Please enjoy today's conference, and thank you for coming.

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[1] Sumeet Batra, Richard Ciccotelli, and Jacqueline Fenton assisted in preparing these remarks.

[2] See William C. Dudley, The Importance of Incentives in Ensuring a Resilient and Robust Financial System, March 26, 2018.

[3] Keeton, William & Kahn, George A. & Schroeder, Linda & Weiner, Stuart E., 2003. "The role of community banks in the U.S. economy," Economic Review, Federal Reserve Bank of Kansas City, issue Q II, pages 15–43.