

## Michelle W Bowman: A conversation on community banking

Speech by Ms Michelle W Bowman, Member of the Board of Governors of the Federal Reserve System, at the Conference for Community Bankers, sponsored by the American Bankers Association, San Diego, California, 11 February 2019.

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Good morning. It is a pleasure to be here today to talk about the Federal Reserve's commitment to and oversight of community banking. I appreciate the invitation to attend the American Bankers Association's Conference for Community Bankers, as community banking has been a focus of my career and plays a vital role in supporting our economy. I believe it is particularly important to bring together community bankers at conferences like this to discuss issues impacting your banks and the communities that you serve.

As many of you know, before joining the Federal Reserve, I was a community banker and more recently had the privilege to serve as the Kansas State Bank Commissioner. While I'm not the first community banker to serve on the Board, I now have the honor of being the first governor to fill the role designated for someone with community banking experience on the Federal Reserve Board, a position that was created by statute in 2015.<sup>1</sup> I plan to fulfill this unique responsibility by traveling widely and listening closely to community bankers, consumers, small business owners, community leaders—all of the stakeholders with an interest in this area. I will take back the knowledge I gain from these discussions and use it to improve our work. And in the process, I hope to help you better understand what the Federal Reserve is doing and what we are trying to accomplish. In doing so, I am confident our work will be more effective and efficient.

As you all know well, community banks are a critical engine of the economy, and they play a key role in providing access to credit in communities of all sizes—big, small, rural, and every size in between. Community bankers not only assist in making people's dreams come true—whether the dream is starting a small business, buying a home or farm, or financing a car. They also provide critical leadership in their communities in many ways—including serving on local boards of schools and hospitals, donating to nonprofits, and volunteering in the community. For all of these reasons, and more, I firmly believe a thriving community banking sector is important to the health of the economy.

Like many of you, I witnessed firsthand how community banks were significantly affected by the Global Financial Crisis, a crisis they did not cause. In my work as state bank commissioner, I learned how bank failures affected cities and towns across the country, and in my home state of Kansas I saw the profound effects a single failure can have on a community. To ensure that community banks can continue to meet the credit needs of their communities, the Federal Reserve and other banking agencies strive to achieve a fair balance between safety and soundness and reducing unnecessary regulatory burden. Given the straightforward nature of community banking, regulators have an obligation to develop and refine approaches to supervision that fit the smaller size and less-complex risk profiles of these banks. If we keep our focus on appropriately tailoring regulatory requirements for community banks so they may continue to prudently thrive, then community bankers should be able to devote more resources and time to serving their customers and communities.

Ultimately, when access to credit is limited, communities suffer and so does the larger economy. In view of these goals and contributions, and an understanding that systemic risk is not likely to be posed by any single community bank, the Federal Reserve continues to tailor supervision and refine our approach to risk-focused examinations of community banks. We are also charged with supervising financial institutions to make sure they comply with applicable federal consumer protection laws and regulations. Here too, we apply a risk-focused approach to consumer compliance supervision, focusing most intensely on those areas involving the greatest

compliance risk. Similarly, we want to ensure that rules that address the risks posed by the business models of the largest banks do not unintentionally create barriers to entry or unnecessary burden for community banks.

During the remaining time with you today, I will touch on the condition of community banks, and supervision and regulation of community banks. I am also interested in hearing your perspective on the challenges and opportunities in the current community bank landscape.

## **Condition of Community Banks**

When I analyze how community banks are faring, I always keep in mind that the range of institutions we call community banks is remarkably diverse. As Kansas State Bank Commissioner, I oversaw banks that had four employees and less than \$20 million in assets up to institutions with more than 100 employees and more than \$1 billion in assets. It's the same picture nationwide. Though if we look more closely, we can see that three out of four community banks hold assets of less than \$500 million. As a regulator, I am particularly interested in how our work affects institutions of this size.

One good reason for this interest is the distinct contribution community banks make to economic activity. For example, while community banks account for just 17 percent of financial industry assets, they are responsible for some 53 percent of bank lending to small businesses.

Further, the health of the community banking sector has improved significantly since the financial crisis. Over the past decade, the majority of community banks have maintained high common equity tier 1 capital levels—consistent with the “well-capitalized” designation under regulatory capital standards. Though there are considerable challenges to the community bank model, these banks continue to post strong earnings, which, in turn, contribute to healthy capital accounts.

In fact, given the sound condition of the banking industry, there were no community bank failures in 2018. Our job now is to ensure that community banks continue to remain strong. That requires bankers and supervisors alike to stay vigilant in the management and supervision of risks facing these institutions and the community bank model.

While banks are performing well and loan portfolios are growing, we want to ensure that loans are underwritten prudently. We also want bankers to actively manage concentrations of credit risk, and be mindful that strong lending activity can strain liquidity. For example, concentrations of commercial real estate are rising, and are quite high at some banks, prompting us to remind bankers of the difficulties that such concentrations presented in the past.

We also continue to focus on concentrations of agricultural credit. In an ongoing effort to understand the emerging risks related to agricultural lending, the Federal Reserve Bank of Kansas City facilitates a National Agricultural Credit meeting semiannually. In late March of this year, the Federal Reserve will be hosting this meeting in Washington, D.C. In April, the Board will meet with the Community Depository Institution Advisory Council. I view meetings like these as important learning opportunities where I can hear directly from leaders in the field about the challenges and opportunities in community banking.

These meetings and direct lines of communication with community bankers help to inform one of the Board's primary goals of ensuring that both supervisory programs and regulations are appropriately tailored to the size, complexity, and risk of a financial institution.

## **Supervision and Regulation of Community Banks**

The Federal Reserve and other federal banking agencies have demonstrated a commitment to reducing regulatory burden, especially on community banks, while maintaining safety and

soundness. In particular, the Federal Reserve has acted to implement provisions of S. 2155 that provide relief to community banks.

Several proposals were issued at the end of last year, and I'd like to encourage this group to submit your views and comments on these proposals. It is important for the Federal Reserve and other regulatory agencies to receive input directly from community bankers. One of these important proposals is to implement the community bank leverage ratio. While the community bank leverage ratio proposal would increase the minimum leverage ratio for banks that opt in to the new framework, the proposal would allow qualifying community banks to opt out of the more complicated risk-based capital framework. Other proposals include raising to \$400,000 the threshold for determining when an appraisal is required for a residential real estate transaction, and excluding community banks from the Volcker rule.

The Federal Reserve also acted to raise the asset threshold from \$1 billion to \$3 billion of total consolidated assets for the Small Bank Holding Company and Savings and Loan Holding Company Policy Statement. This change allows more banking companies that have limited access to the capital markets to take advantage of using debt in bank acquisitions. This helps foster local ownership of small banks. The change also exempts eligible small holding companies from consolidated risk-based capital rules, a significant burden reduction.

In December, the federal banking agencies issued a final rule allowing qualifying insured depository institutions with less than \$3 billion in total assets to benefit from an extended 18-month on-site examination cycle. This increases the former threshold of \$1 billion and provides examination burden relief to a substantial number of community banks with relatively simple risk profiles.

With respect to supervision, the Federal Reserve continues to tailor and reduce burden by conducting portions of community bank examinations offsite. However, we also understand the importance of face-to-face interaction and continue to be responsive to bankers' requests for on-site examinations.

The Federal Reserve has also implemented a risk-focused supervisory program—the Bank Exams Tailored to Risk (BETR) program—which aims to identify low-risk activities within state member banks and apply appropriately streamlined examination work programs to these activities, and conversely, to identify high-risk activities within state member banks for prompt supervisory attention.

This enhanced tailoring of supervision minimizes regulatory burden for the many community banks that are well managed, and directs supervisory resources to higher-risk activities where they are most needed to contain the risks that can result from aggressive banking strategies. Similarly, the Federal Reserve tailors its supervision of holding companies based on the size, complexity, and risk profile of each institution.

## **Closing Remarks**

As I conclude, I would emphasize how crucial it is to balance effective regulation and supervision to ensure the safety and soundness of community banks while also ensuring that undue burden does not constrain the capacity of these institutions to support the communities they serve.

As I previously noted, one of the most important aspects of my job, as I see it, is to have open lines of communication and feedback between regulators and community banks and bankers. As a former community banker and state regulator, I understand how clear communication can help us all do our jobs better. So, I encourage you—and everyone with a stake in this work—to share your thoughts on the impact of regulation on community banks and the communities they serve. This dialogue is especially important as we continue to work to tailor our supervision and regulation to the size and risk profile of the institutions we oversee. Although we have different

responsibilities, I believe we can agree that we must keep our financial system strong, while maintaining the ability of community banks to fulfill their important role in our economy.

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<sup>1</sup> Terrorism Risk Insurance Program Reauthorization Act of 2015, Pub. L. No. 114–1, 129 Stat. 3.