Michelle W Bowman: Community banking

Speech by Ms Michelle W Bowman, Member of the Board of Governors of the Federal Reserve System, at the Robbins Banking Institute Lecture Series, Hays, Kansas, 27 February 2025.

* * *

It is a pleasure to join you today at Fort Hays State University for the Robbins Banking Institute Lecture.[1] I have been a supporter of this institute since it was first created here at Fort Hays State, including by giving a lecture to students during my tenure as the Kansas State Bank Commissioner. Today, my view is slightly different than at that time, and I thought it would be a good time to share my thoughts on the critical role community banks play, not only in the U.S. banking system but also as drivers of local and regional economic growth and as anchors of their local communities. I will also explore the responsibility of bank regulators to support community banks.

In a broad and diverse economy, banks of all sizes play an important role in the creation and funding of business and consumer opportunities and investments. Without this diverse banking ecosystem, 30 percent of American communities would not have access to a physical bank location. There is little doubt that community banks have an extensive presence across this landscape and that they are essential to the success of the American economy.

No other country in the world enjoys this direct access to and presence of financial services in remote and rural areas. These bankers are members of the community. They are neighbors and friends, and their kids attend local schools and play sports in the local recreational league. The term "relationship" banking has true meaning in this context.

The direct relationships provide an opportunity for bankers to understand the unique financing needs of local businesses and enables them to develop specialized services for specific segments of the local economy, including agriculture and small business lending.[2]

Community banks are catalysts for local economic growth, and their bankers often also serve as civic leaders in the region. I served as one of those community leaders while I was a banker in Council Grove. That experience-whether serving as the President of the local Chamber of Commerce or the Rotary Club-provided a unique view into the local economy. And today, as I travel across the country to visit with bankers in just about every state, I learn about how they are driving investment, philanthropy, and financial support for the local economy. While this work is rewarding, it is also challenging. It is sometimes tedious-especially in today's regulatory environment-and it is a seven days a week job. Bankers are often "working" while engaged in social activities, attending church or their kids athletic events, and shopping at the grocery store, and I often hear about customers giving a loan payment to their banker in the grocery store or asking about financing terms for the new car they might have their eye on.

Once a policymaker grasps the perspective of community banking from this vantage point, it becomes clear that the regulatory approach is much more complex than necessary to address many small bank issues. A community bank that has no out-of-market customers applying for new accounts likely does not need the same know-your-customer processes as a large or regional bank that opens accounts online and may be more vulnerable to fraud. A community bank can operate safely and soundly, and in compliance with laws, without being subject to the same extensive guidance and regulatory requirements as larger, more complex banks that offer a broader range of products and may be exposed to wider range of risks. A number of onerous requirements imposed on community banks seem to reflect an assumption of an indirect and less personal banking relationship.

Public debates about the banking system often feature academics that tend to downplay the significant role of community banks in the financial system. Instead, they imagine a banking system with fewer banks as equally effective in meeting the banking needs of every community throughout the United States. The eight largest U.S. banks hold $15.4 trillion in assets, which is several times larger than the assets controlled by the more than 4,000 community banks in the United States.[3] But as we all know, aggregate asset size is not an accurate indication of these banks' importance.

Of course, metrics do not provide the full picture of how relationship-based lending practices drive local economic activity. They ignore that banking has a regional component, where local knowledge and expertise-and a commitment to the local community-can help enable the community to thrive. There is an important place for the largest banks and regional banks in the banking system, but it is a fallacy to assume that the presence of fewer community banks would not have devastating consequences for a number of consumers and businesses. Some community banks serve rural and underserved banking markets and may be the only option for consumers and businesses, especially those that have unique balance sheets or less pristine credit histories. If community banks were to disappear, many communities would be left with few or no alternative options for banking services.

While metrics do not tell the whole story, this is not meant to downplay the importance of data, research, and analysis, all of which assist us in our understanding of the banking system and how that understanding could be improved. Data can help us identify issues that must be addressed or remediated. Data can help us evaluate which elements of the current bank regulatory framework may be effective or ineffective. And data can help regulators update regulations and guidance with a clearer understanding of the intended and unintended consequences.

Over the past 20 years, we have seen the number of community banks continue to decline. Bank consolidation through mergers has contributed to this decline, and de novo bank formation has been largely nonexistent. Many factors have contributed to the bank consolidation trend, including competition from nonbank financial service providers and the ever-increasing regulatory burdens on the community banking model. Many of these same challenges have acted as a deterrent to bankers who have considered pursuing a de novo bank charter. And while many factors influence the health of the community bank model-including the interest rate environment, economic conditions, and alternative sources of competition for credit-we should consider whether there are actions regulators can take to support and ensure the future of community banks.

The Benefits of Experience

One of the biggest barriers to the community bank model is the competition for qualified bank management and staff. Attracting, developing, and retaining future and current bank leadership is a significant challenge. Yet, one of the most important priorities for bank management is to develop the next generation of leadership. Educational programs like this institute, bank and regulator internships, and regional graduate schools of banking can help develop this pipeline of talent to support the industry and supervisory responsibilities. These programs also help regulators recruit the next generation of bank examiners.

Working in my family's community bank reinforced the mission focus and relationship model of community banking for me. This holds true for many family-owned community banks across the country.

Since we are on the campus of Fort Hays State University today and we have a number of students in the audience, part of my message today is to encourage each of you to consider exploring a career in the financial services industry-including in community banking or with a state or federal banking regulator. Whether that experience becomes a lifelong career or a stepping stone along your path, having experience in banking provides valuable perspective on how local economies function and the importance of access to banking services and financial inclusion. This experience has helped to shape my perspective and approach as the state bank commissioner and as a member of the Board of Governors of the Federal Reserve System.

This experience is also not something that I take for granted-seeing different perspectives empowers me to be a better policymaker. For example, as a bank compliance officer you understand the challenges of ensuring the bank is in compliance with rules and guidance and is prepared for interactions with bank examiners. Further, having this perspective enables a policymaker to approach the process of drafting rules and guidance and relaying supervisory messages in a way that recognizes a need for clarity, efficiency, and simplicity. The outcomes of our work are enhanced by a better understanding of the costs and unintended consequences of getting it wrong.

The Responsibility of Regulators

Overregulation and unnecessary rules and guidance imposed on smaller and community banks create disproportionate burdens on these banks, eventually eroding the viability of the community banking model.

Policymakers and regulators have a responsibility to ensure that the banking and financial systems encourage growth and innovation and foster a strong and growing economy. One of the great strengths of the U.S. banking system is the variety of institutions that meet the needs of consumers and businesses, not only through offering a range of products and services but also by reaching customers throughout the country, including in the most rural and remote locations. Our goal must be to facilitate a banking and regulatory environment that enables banks of all types and sizes to thrive. For community banks, this includes building a better regulatory and supervisory framework to effectively support the unique characteristics of these institutions.

What should that framework look like?

First, it includes thresholds that better reflect risk and business model.

As currently defined, community banks are those with less than $10 billion in assets. The Federal Reserve divides banks into distinct supervisory portfolios that oversee "community," "regional," and four categories of larger banks.[4] The portfolio approach helps regulators differentiate standards and supervisory focus based on bank characteristics and risks. In theory, it allows examiners to better organize supervisory activities and to provide specialized training to help examiners focus on issues that are most relevant for the institutions being examined. If appropriately executed, this portfolio-based approach should lead to better and more risk-focused supervision, and in turn a safer and more sound banking system.

An organizational structure that better allocates and directs supervisory resources seems like a worthwhile goal, but over time, it becomes clear that there are downsides to this approach. One of these downsides is the static nature of the fixed thresholds defining the categories. Currently, our framework includes fixed thresholds that are not adjusted with economic growth, inflation, or the growth in deposits from unexpected sources and fiscal programs, like those from the COVID era. They also do not account for changed industry dynamics, especially those resulting from a particular bank's activities or risk profile. In this environment, some firms with stable growth, a static business model, and a straightforward risk profile cross the $10 billion threshold unintentionally, subjecting them to additional regulatory and supervisory requirements that were specifically designed and implemented for larger and more complex firms. Banks approaching the $10 billion threshold often choose to curtail their asset growth to stay below the threshold.

Another significant problem with the current approach-that specifically challenges community banks-is the failure to index and update how a community bank is defined. Given the low fixed-dollar asset thresholds, regulators must focus on ensuring that asset-based benchmarks remain reasonable and appropriate in their work to supervise banks, especially as they apply tailored, but static, supervisory standards. As is the case now, over time, economic growth and inflation have created an environment in which thresholds are inappropriately low.

We also need to implement a better, more timely, transparent, and viable path for all bank regulatory applications. The application process can be a significant obstacle to applications activity, in particular mergers and acquisitions. Applications often experience significant delays between the application filing date and before receiving final regulatory approval. In some cases, even for non-complex transactions, the regulatory approval process has taken more than a year. A healthy banking system is one in which banks can make decisions to merge with peers or acquire new assets or business lines, and one that allows new bank formation, in a reasonable amount of time in accordance with statutory timelines. As the bank applications process has become a barrier to bank merger activity, we have seen credit unions acquiring community banks in record numbers. In the absence of a better functioning bank applications process, institutions will explore other options, including credit union acquisitions.

I think this trend should be a wake up call for regulators to reevaluate our approaches to many areas of our responsibility, but especially whether our applications processes are operating as effectively and efficiently as they should. It is important that the regulatory framework ensures that competition and broader availability of banking services remain a feature of the U.S. banking system.

A necessary approach to solving this is by making targeted improvements to the applications process. If you follow my work, you know that I often discuss how the applications process can be improved.[5] So I will note some of the important changes that I believe would be a catalyst to returning our bank applications review function to an appropriate processing timeline. These are simply threshold steps that should be easy to accomplish and would be a great start to fundamentally improving the process.

I believe that we should not be complacent when facing excessive and longstanding delays. For bank applications, we must focus our resources and expertise to review and promptly act on all bank applications, to streamline the required forms and procedures, and to provide clear standards for approval.

Bank regulators should be prepared to act promptly on applications, and yet the significant delays in applications processing we see suggests we can do better. The published statistics on applications processing also tell an incomplete story, as they do not reflect the time spent by applicants who withdraw applications before final regulatory action or that simply forgo business opportunities that require an application out of concern that the regulatory approval process is too uncertain and unpredictable.[6]

Many banks experience these frictions in the applications process firsthand. And judging from the number of bankers that contact me as they experience unexplained and prolonged delays, there is clear need for improvement. Uncertainty regarding the status of the application and an expected timeline for resolution creates challenges in moving forward with related business processes often resulting in costly delays for systems conversions and unhealthy uncertainty among bank staff.

We can certainly learn from the inefficiencies in the current process and leverage these experiences by consulting with banks about these challenges and identifying a clear path to improve the process. One step could be to ensure that our applications teams have access to specialized knowledge required to more effectively approach applications for infrequent activities, like de novo formations. We should ensure that a Reserve Bank has the resources necessary to assist them in making the applications process smooth, and ensuring prompt action is taken on the application.

We also know that the applications process itself can be a significant barrier and has in recent years been used by regulators to delay decisions. While many activities that require regulatory approval rely on common application forms, some bank applications require regulatory approvals from multiple regulators. Even where only one primary federal regulator must act on an application, there may be requirements to solicit views from other regulators, or the need to request additional information from the applicant that was not included in the initial filing forms.

Each additional step in the process can lead to delays and prolonged uncertainty. Without question, there is a better process, and it should start with aligned requirements across the banking agencies, coordinated review processes, and clearer standards for approval.

The standards for approval should be clear to all applicants and consistently applied. This must include transparency not only in approval standards but also in timelines, which are equally critical to banks seeking regulatory approval. Banking applications are not filed without extensive work up front and specific plans in mind. For example, a merger application will include information about the pro forma institution's management team, geographies to be served in the merged institution's banking footprint, what products will be offered, and how the application will be consistent with the various statutory approval standards.

If we determine that we consistently need more information to process an application, we should amend the applications form instead of relying on time-consuming additional information requests that extend the decision timeline. And if there are standards we expect applicants to meet-for example, the minimum amount of capital required for a de novo bank formation or an expansionary proposal-we should be clear and transparent about those expectations in advance.

Uncertainty in the standards and timelines for action on bank applications can contribute to a regulatory environment that favors nonbanks. This more favorable treatment includes allowing them to engage in the same activities without the same regulatory burdens, like more favorable tax and regulatory treatment for credit unions and the exemption from Community Reinvestment Act requirements for nonbank financial institutions, again, including credit unions. Why would a new business choose to become a bank if they can avoid the complexities of the banking regulatory framework and still provide similar services?

Tailoring

While these steps-developing a pipeline of future leadership for community banks and promoting a more efficient bank applications process-would help support the community banking system generally, perhaps the most critical feature of the framework that affects community banks is tailoring to address the ongoing burden of compliance.

Tailoring is the term we use in banking to describe an approach to regulation that strives to match regulation and supervision with the size, risk, complexity, and business model of an institution. Tailoring helps us calibrate regulation and supervision to the activities and risks at every tier within our framework, but it is particularly important when we think about its application for smaller and community banks.

Frankly, when you consider the fundamental differences between the largest banks and the smallest, tailoring seems like common sense rather than a distinct regulatory philosophy. But in the absence of industry experience among bank policymakers, the trend over time has been an erosion of tailoring in favor of one-size-fits-all approaches.

Pushing down requirements more appropriate for larger institutions to smaller banks-either formally through regulation or informally through supervisory messaging-encourages homogenization of the industry. This trend becomes even more concerning when regulators "grade on a curve" by evaluating a bank *relative* to other institutions, instead of evaluating a bank *against a clear legal standard*.

It is also important for regulators evaluating regulations and supervisory approach to consider the aggregate benefits and costs of the framework, rather than looking at each part of the framework on a piecemeal basis. Often, the regulations and supervisory guidance issued by regulators has a "cumulative" or "compounding" effect on banks. A piecemeal approach ensures that banks cannot go to a single source or one regulation to understand supervisory expectations or requirements for a particular activity. While it may be possible to justify or explain any single regulation or piece of guidance on a standalone basis, when we consider the aggregate effects, it is clear that we need to rethink our approach and recommit to tailoring.

Regulatory ambivalence to tailoring comes at a significant cost. If current trends continue-where we push down requirements from large banks to small and attempt to "smooth" or standardize requirements and expectations across all banks-we will eventually find ourselves achieving the academically preferred end state of only a few large banks ineffectively serving the financial needs of the entire U.S. economy. In this state of the world, not only will community banks suffer but so will the communities they serve.

Closing Thoughts

Thank you again for the invitation to join you today. It is wonderful to see the ongoing success and commitment of the Robbins Banking Institute in preparing the next generation of leaders to play an important role in the banking and financial system. While I have expressed concern about some recent trends, one of the many benefits of our system is that there are always opportunities to change course, and I am confident that with committed and experienced leadership we can.

I am also confident that the future of community banking is bright, as long as we focus on right sized and appropriate regulations and guidance and a recognition that investment in innovation and growth is a necessity, not a roadblock. Regulators have an important opportunity now to prioritize changes that will support the safe and sound operation of community banks while allowing these banks to support the U.S. economy, serve their communities, innovate, and grow. Community banks enable the economic success of our country and will continue to support financial opportunities for many future generations. I look forward to seeing how the students in attendance here today will be a part of and shape that bright future.

---

[1] The views expressed in these remarks are my own and do not necessarily reflect those of my colleagues on the Board of Governors of the Federal Reserve System or the Federal Open Market Committee.

[2] Allen N. Berger, Nathan H. Miller, Mitchell A. Petersen, Raghuram G. Rajan, and Jeremy C. Stein, "Does Function Follow Organizational Form? Evidence from the Lending Practices of Large and Small Banks (PDF)," National Bureau of Economic Research, Working Paper 8752 (Cambridge, MA: NBER, February 2002).

[3] See, e.g., Board of Governors of the Federal Reserve System, *Supervision and Regulation Report* (PDF) (Washington: Board of Governors, November 2024), Table 2, Summary of organizations supervised by the Federal Reserve (as of 6/30/2024).

[4] Larger banks are defined using tests that look primarily at asset size but may include other metrics like cross-jurisdictional activity, nonbank assets, short-term wholesale funding, or off-balance sheet exposures.

[5] Michelle W. Bowman, "Brief Remarks on the Economy and Accountability in Supervision, Applications, and Regulation (PDF)" (remarks at the American Bankers Association 2025 Conference for Community Bankers, Phoenix, AZ, February 17, 2025).

[6] See, e.g., Board of Governors of the Federal Reserve System, *Banking Applications Activity Semiannual Report, January 1-June 30, 2024* (PDF) (Washington, Board of Governors, October 2024).