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Community Banking

Remarks by

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I'm glad to have the chance to speak again to the Independent Community Bankers of America, even if it's by way of prerecorded remarks. This will be the first time in quite a few years that I haven't been with you in person, but, as you may know, the Federal Open Market Committee met just yesterday in Washington, so I am unable to join you in Nashville. I have very much enjoyed attending these annual ICBA get-togethers, especially since I get the chance to hear directly from you about what's happening in your local economies and in community banking more generally. It's a tradition I hope to reestablish in the future.

The Role of Community Banks in a Challenging Economy

Community banks remain a critical component of our financial system and our economy. They help keep their local economies vibrant and growing by taking on and managing the risks of local lending, which larger banks may be unwilling or unable to do. They often respond with greater agility to lending requests than their national competitors because of their detailed knowledge of the needs of their customers and their close ties to the communities they serve.

As you well know, however, community banks are also facing difficult challenges. Their close ties to local economies are, on balance, a source of strength, but a drawback of those ties is that the fortunes of communities and their banks tend to rise and fall together. Another concern for community banks is the narrowing of the range of their profitable lending activities: Because larger banks have used their scale to gain a pricing advantage in volume-driven businesses such as consumer lending, community banks have tended to specialize in other areas, such as loans secured by commercial real estate. That said, I know that community banks are continuing to look for ways to prudently diversify their revenue sources.

Like larger banks, community banks are also being affected by the state of the national economy. Despite some recent signs of improvement, the recovery has been frustratingly slow, constraining opportunities for profitable lending. And, as I will discuss momentarily, actual and prospective changes in the regulatory landscape have also raised concerns among community bankers.

The good news is that, for the most part, community banks appear to be meeting their challenges. Profits of smaller banks were considerably higher in 2011 than in the previous year, nonperforming assets were lower, provisions for loan losses fell appreciably, and capital ratios improved.

Outreach and Communication with Community Banks

As I noted, together with economic conditions, regulation and supervision are among the top concerns for community banks. In that regard, I think we would all agree that two-way communication between regulators and community banks is critical. Banks need to understand supervisors' policies and expectations, but supervisors must also listen to and understand banks' concerns.

At the Federal Reserve, we pursue our dialogue with community bankers through many channels. One important channel is the recently established Community Depository Institutions Advisory Council (CDIAC).[1] The council's membership is drawn from smaller banks, credit unions, and savings associations. Each of the 12 Reserve Banks around the country has a local advisory council, and one representative

[1] For more information, see the Federal Reserve Board's webpage "Community Depository Institutions Advisory Council" available at www.federalreserve.gov/aboutthefed/cdiac.htm.

from each local council serves on the national council that meets with the Board in Washington twice a year.

At a recent meeting, for example, one of our CDIAC members asked us to be clearer about whether particular rules and guidance apply to community banks. Having heard from this banker as well as others, we are now working to more explicitly indicate which banks will be affected when we issue new regulatory proposals, final rules, or regulatory guidance. Although this change seems relatively simple, we hope it will help banks avoid allocating precious resources to poring over supervisory guidance that does not apply to them.

In addition to the advisory council, the Board last year established a supervision subcommittee on smaller regional and community banking. Because of their professional backgrounds in community banking and bank supervision, I asked Governors Elizabeth Duke and Sarah Bloom Raskin to serve on this subcommittee. Its primary role is to improve our understanding of community and regional banking conditions and to review policy proposals for their potential effect on the safety and soundness of, and the regulatory costs imposed on, community and regional institutions.[2] Governors Duke and Raskin are also keenly interested in how our policies could affect the availability of credit to sound borrowers.

We have other contacts with community banks that have proved valuable. For quite a few years, the Reserve Banks have maintained local training and outreach programs for banks. More recently, several of these programs have been expanded

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[2] For the purposes of the Federal Reserve's supervisory programs, regional banking organizations generally are considered to be those banks and bank holding companies (including savings and loan holding companies) with total consolidated assets between $10 billion and $50 billion.

nationally. For example, the Federal Reserve Bank of St. Louis organizes national "Ask the Fed" calls to provide bankers with an opportunity to hear Federal Reserve staff discuss recent policy initiatives and issues that examiners are encountering in the field. In addition, the Federal Reserve Bank of San Francisco hosts consumer compliance webinars, and the Federal Reserve Bank of Philadelphia publishes a quarterly overview of consumer compliance issues that allows Federal Reserve staff to address questions from banks.[3] We are exploring options for building on these initiatives. It is critical to keep the communications channels open if supervisors and banks are to work together constructively.

The Regulation and Supervision of Community Banks

Bank supervision requires a delicate balance--particularly now. The weak economy, together with loose lending standards in the past, has put pressure on the entire banking industry, including community banks. To protect banks from new problems down the road, and to safeguard the Deposit Insurance Fund, supervisors must insist on high standards for lending, risk management, and governance. At the same time, it is important for banks, for their communities, and for the national economy that banks lend to creditworthy borrowers. Lending to creditworthy borrowers, after all, is how banks earn profits.

We also know that supervision imposes costs on institutions, and we recognize that new regulations and supervisory requirements may impose disproportionate costs on community banks. Thus, we take quite seriously the importance of evaluating the costs

[3] For archived webinars and publications as well as announcements about future events, see the Federal Reserve Bank of Philadelphia's webpage "Consumer Compliance Outlook" available at www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook.

and benefits of new rules. Supervision is conducted through the Federal Reserve's decentralized structure of 12 regional Reserve Banks, which helps us tailor our examinations and supervision to the size, complexity, risk profile, and business model of each institution.

Community bankers tell us repeatedly that they are concerned about the changing regulatory environment. One particular worry is the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). It is important to emphasize that the Congress enacted the Dodd-Frank Act largely in response to the "too big to fail" problem, and that most of its provisions--regarding, for example, capital, liquidity, and risk management--apply only, or principally, to the largest, most complex, and internationally active banks. These new standards are not meant to apply to, and clearly would not be appropriate for, community banks. We will work to maintain a clear distinction between community banks and larger institutions in the application of new regulations.

Conclusion

To conclude, I would like to reemphasize the importance that my colleagues on the Board and I place on the Federal Reserve's relationship with community banks. The Fed is committed to fair, consistent, and informed examinations that take into account the size, complexity, and individual circumstances of each bank we oversee. We will do all we can to support the banks' safety and soundness and eliminate unnecessary costs. Despite economic uncertainties, the condition of community banks is improving. That's good news not only for banks, but for their communities and the national economy as well. Thanks, and enjoy the rest of your meetings.