FEDERAL RESERVE BANK *of* NEW YORK *Serving the Second District and the Nation*

SPEECH

A Supervisory Perspective on the U.S. Banking System

December 01, 2022

Dianne Dobbeck, Head of the Supervision Group

Remarks at the Financial Times Global Banking Summit (delivered via videoconference)
As prepared for delivery

Thank you, Laura, and hello to those of you attending in-person and virtually. It is a pleasure to be speaking at the Global Banking Summit.

The New York Fed is responsible for supervising a wide range of financial institutions, from some of the nation's largest banks, to the U.S. operations of foreign banking organizations, to regional and community banks. We also have oversight responsibilities for financial market utilities and significant service providers. I'm looking forward to sharing some perspectives from this unique vantage point.

I'll begin my remarks today with an overview of the current state of the U.S. banking system. Then, I will highlight a few risks in the present environment. I want to note that my remarks today are my own and do not necessarily reflect the views of the Federal Reserve Bank of New York or the Federal Reserve System.

Current State of the Banking System

The U.S. banking system entered the year in sound condition, but market conditions are changing and, as Vice Chair for Supervision Michael Barr recently said, we must ensure we are keeping pace as supervisors. [1] Let me discuss in more detail.

The vast majority of banks remain above regulatory capital minimums. [2] For large banks, we conduct annual tests to assess their capital positions under a stressed economic scenario. The Fed's most recent stress test showed that large banks would maintain capital above minimum requirements in a simulated severe downturn. [3]

Banks' liquidity profiles also remain ample. [4] As described in the Fed's semiannual Supervision and Regulation Report, large banks maintain sufficient liquidity to meet modeled stressed outflows. [5]

Financial performance has also been stable. Banks continue to provide their core financial services of lending, deposit taking, payments, and market intermediation. Year to date, total loans have grown at an annualized rate of over 10%, with robust growth across household and corporate borrowers. [6] Return on equity remains in line with historical levels. [7]

While the current picture is one of resilience, we remain attuned to risks faced by banks. I'll highlight three risks we are focused on from a supervisory perspective.

An Unfamiliar Economic Environment

The first risk relates to the unfamiliar, uncertain, and fast-changing economic environment. Interest rates are one example. Higher interest rates have benefited net interest margins, but they have also led to significant unrealized losses in banks' securities portfolios. For the broader banking system, declines in the value of securities have led to reductions in liquidity. Interest rate risk remains a watchpoint.

Higher interest rates could also challenge some borrowers' ability to service or repay debt, particularly for borrowers with interest payments tied to floating rates. For example, commercial real estate loans are often linked to floating rates, and the outlook for commercial properties is also affected by the shift to remote work. [8] This sector is particularly relevant to the New York Fed—one of the largest commercial real estate markets in the world is in our district. [9]

Improving our Understanding of Climate-Related Financial Risks

The second risk I'll highlight relates to climate change, which poses financial risks to individual banks and the financial system. Here, the Federal Reserve Board is leading workstreams that will enhance supervisors' and banks' ability to understand and manage these risks. Early next year, the Board will conduct a pilot study with six of the largest U.S. banks to analyze the impact of different climate scenarios. [10] Four of those banks are headquartered in New York.

This exercise will provide supervisors and banks with insight into how climate-related financial risks may manifest. It will also help with the management of those potential risks.

The pilot exercise is distinct from the annual stress tests the Federal Reserve conducts. It will not result in supervisory or capital implications—rather, it will be a way for both banks and supervisors to learn.

Banks' Engagement in Crypto-Asset Activities

The third and final risk I'll highlight is related to banks' engagement with crypto-assets and crypto-asset-related businesses. Financial innovation presents opportunities, but it can also present risks—to banks, customers, and the financial system. The growing size of the crypto-asset industry, the volatility of underlying crypto-assets, and the recent failures of crypto-asset-related businesses make clear the need to evaluate banks' engagement in this space.

At present, U.S. banks' direct involvement in crypto activity is small and largely in the planning stages. Banks' provision of traditional financial services to crypto-asset-related businesses also remains limited. However, the risks associated with future activity can be hard to quantify.

In August, the Federal Reserve outlined key steps that banks should take before engaging in crypto-asset-related activities. These include notifying the Federal Reserve before engaging in crypto-asset-related activities and having effective controls and systems in place to manage associated risks. [11] Key risk management considerations will vary with the type of activity. For example, if a bank accepts crypto-related deposits, it must consider the funding implications in the event those deposits were to exit the bank quickly.

Importance of Strong Risk Management Practices

Through our supervision work at the New York Fed, we will continue to monitor, examine, and evaluate these and other risks to promote the safety and soundness of the banking system. While the banking system is currently resilient, it is essential that banks have strong risk management practices to identify challenges and maintain resiliency in this evolving environment.

Thank you, and I look forward to our discussion.

---

[1] See Vice Chair for Supervision Barr's November 15, 2022, testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, at https://www.federalreserve.gov/newsevents/testimony/barr20221115a.htm .

[2] See page 1 of November 2022 Supervision and Regulation Report, at https://www.federalreserve.gov/publications/files/202211-supervision-and-regulation-report.pdf

[3] See June 23, 2022, press release, "Federal Reserve Board releases results of annual bank stress test, which show that banks continue to have strong capital levels, allowing them to continue lending to households and businesses during a severe recession," at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20220623a.htm

[4] See pages 6, 7, and 11 of November 2022 Supervision and Regulation Report, at https://www.federalreserve.gov/publications/files/202211-supervision-and-regulation-report.pdf

[5] Ibid., page 24.

[6] See H.8 Assets and Liabilities of Commercial Banks in the United States, released on November 18, at https://www.federalreserve.gov/releases/h8/20221118 .

[7] See page 4 of November 2022 Supervision and Regulation Report, at https://www.federalreserve.gov/publications/files/202211-supervision-and-regulation-report.pdf

[8] Ibid., page 29.

[9] See "16 U.S. Metros are in Top 30 Largest Commercial Markets Globally in 2020: NYC is the Number One CRE Market," at https://www.nar.realtor/blogs/economists-outlook/16-u-s-metros-are-in-top-30-largest-commercial-markets-globally-in-2020-nyc-is-the-number-one-cre

[10] See September 29, 2022, press release, "Federal Reserve Board announces that six of the nation's largest banks will participate in a pilot climate scenario analysis exercise designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks" at https://www.federalreserve.gov/newsevents/pressreleases/other20220929a.htm

[11] See SR Letter 22-6, "Engagement in Crypto-Asset-Related Activities by Federal Reserve-Supervised Banking Organizations," at https://www.federalreserve.gov/supervisionreg/srletters/SR2206.htm .