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SPEECH

# Remarks at the New Jersey Bankers Association Regional Meeting

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**Remarks at the New Jersey Bankers Association Regional Meeting, Woodbridge, New Jersey**

As prepared for delivery

Thank you for having me here today. It's a pleasure to be speaking at the regional meeting of the New Jersey Bankers Association. In my remarks, I'll share some supervisory perspectives on current conditions in the banking sector. In our discussion to follow, I look forward to hearing more from you about the opportunities and risks facing your banks. 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.

This past spring, the banking sector faced significant stress as some banks experienced large and extremely rapid deposit outflows. Since the spring, the pressure on the banking sector has abated, and the banking system remains sound and resilient. Banking organizations maintain regulatory capital in excess of regulatory requirements.[1] Profitability for the sector in 2023 has remained above its 10-year average.[2] Delinquency rates remain low, although some loan sectors have seen limited deterioration year-to-date.[3]

While the banking sector remains resilient, conditions have changed since last year. Loan growth has slowed, falling from 11% last year to 1% through 2023 so far.[4] The slow-down is consistent with the tighter loan standards and weaker demand reported in recent Senior Loan Office Opinion Surveys.[5] Funding profiles have also changed. Reliance on wholesale funding remains low but has increased from its historically low levels at the beginning of 2022.[6] Liquidity remains ample overall, but liquid assets as a share of total assets has declined from its peak in 2021.[7]

As Vice Chair for Supervision Michael Barr recently said, "preserving a sound and resilient banking system requires continued attention to address identified vulnerabilities and vigilance to changing conditions."[8] I'll discuss a few of the vulnerabilities we're focused on at the New York Fed. I'll then close with some remarks on updates to the Community Reinvestment Act.

### Liquidity and Operational Readiness

The rapid deposit outflows experienced by some banks this past spring demonstrate the importance of contingency funding planning. While deposits have stabilized since May, it is critical that all banks have in place contingency funding plans that are actionable, with contingent funding sources that can be accessed when they are most needed.

As supervisors, we often discuss with banks the concept of operational readiness, particularly for discount window borrowing. Steps that support operational readiness include ensuring borrowing agreements are in place, pre-pledging collateral, and conducting test transactions with discount window staff.[9] During March and April 2023, I alongside other New York Fed colleagues spoke with many of you to discuss the importance of operational readiness, to provide background on the Bank Term Funding Program, and to offer follow-up conversations with our discount window colleagues. In July, the Board issued updated guidance on liquidity risks and contingency planning.[10] I encourage you to review this important resource.

### Capital and Interest Rate Risk

One area we're focused on is the interlinkages between liquidity and bank capital. Concerns about solvency can drive deposit outflows. At the same time, deterioration in a bank's regulatory capital position can also reduce access to certain funding sources. For example, a bank that falls below well-capitalized levels may face limitations on its ability to fund itself with brokered deposits.[11] Both large and small banks have increased their reliance on brokered deposits since the beginning of 2022. Reductions in regulatory capital can also limit access to contingent funding. My request is for all banks to review these interlinkages and understand how reductions in capital, including through significant earnings losses, could adversely impact access to existing funding sources.

The effects of higher interest rates are another watch point. Higher interest rates have resulted in reductions in the fair value of assets, especially investment securities and fixed-rate loans.[12] Even when not recognized on bank balance sheets or regulatory capital, unrealized losses on assets can create risks for banks.[13] One clear impact of higher interest rates has been reductions in banks' tangible capital. Tangible capital is another important metric that funding providers routinely review.

### Commercial Real Estate

Commercial real estate (CRE) lending is an important part of many banks' business models, especially in the second district. Given

stress in the CRE market, this is another area we are closely monitoring. While delinquency rates in CRE currently remain low, there has been some recent deterioration, especially in the office category.[14] Community and regional banks would be most affected by losses in the sector given CRE loans make up a greater share of their loan portfolios.

For some CRE borrowers, deterioration in financial condition, such as reduced value of collateral and lower operational cash flows, could hinder repayment. This past summer, the banking agencies issued an update to previous guidance which encourages financial institutions to work "prudently and constructively with creditworthy commercial borrowers experiencing financial difficulties."[15] In certain cases, accommodations and workouts with borrowers may be a prudent course of action.

### Community Reinvestment Act

I'll now turn to the Community Reinvestment Act, or CRA. On October 24th, fifty years after the Community Reinvestment Act's enactment, the federal banking agencies approved a final rule to encourage banks to help meet the credit needs of the local communities in which they do business. Vice Chair for Supervision Barr shared some of the key objectives of the CRA, which I'll reference.[16]

First, the revisions strengthen the core purpose of the statute so that CRA is a strong and effective tool to address inequities in access to credit and enhance financial inclusion.

Second, the final rule modernizes the CRA to reflect the major changes that have occurred in the banking sector since 1995, including mobile and online banking.

Third, the final regulation provides greater clarity and consistency in application of the regulations, including through the adoption of evaluation metrics and public benchmarks. It also provides clarity around which activities qualify for CRA credit through the adoption of clear criteria, a public list of qualifying activities, and a process for banks to confirm whether an activity is eligible.

Fourth, the revisions tailor the requirements of the CRA based on bank size and type.

This is a significant milestone. Examiners across the three banking agencies will continue to work closely together to ensure consistent implementation of the CRA.

### Conclusion

To conclude, the banking system remains sound and resilient. As supervisors, we remain attuned to vulnerabilities and fast-changing conditions affecting the sector. Thank you, and I look forward to our discussion.

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[1] See Board of Governors of the Federal Reserve System, Supervision and Regulation Report (Washington: Board of Governors, November 2023), p. 1.

[2] Ibid.

[3] Ibid., pp. 5-6.

[4] Board of Governors of the Federal Reserve System, H.8, "Assets and Liabilities of Commercial Banks in the United States." Loan growth figures represent annualized year-to-date loan growth for all commercial banks, not seasonally adjusted. 2022 YTD growth measured from December 29, 2021 to November 2, 2022. 2023 YTD growth measured from December 28, 2022 to November 1, 2023.

[5] See, e.g., Board of Governors of the Federal Reserve System, July 2023 Senior Loan Officer Opinion Survey on Bank Lending Practices (Washington: Board of Governors, July 2023).

[6] See Board of Governors of the Federal Reserve System, Supervision and Regulation Report (Washington: Board of Governors, November 2023), p. 5.

[7] Ibid., pp. 1 and 4.

[8] Vice Chair for Supervision Michael S. Barr, Testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C. on November 14, 2023.

[9] See Addendum to the Interagency Policy Statement on Funding and Liquidity Risk Management: Importance of Contingency Funding Plans. See also Vice Chair for Supervision Michael S. Barr, "The 2023 U.S. Treasury Market Conference" (speech at the 2023 U.S. Treasury Market Conference, November 16, 2023).

[10] Board of Governors of the Federal Reserve System, "Agencies update guidance on liquidity risks and contingency planning" press release on July 28, 2023.

[11] See 12 CFR 337.6(b).

[12] See Board of Governors of the Federal Reserve System, Supervision and Regulation Report (Washington: Board of Governors, November 2023), p. 20.

[13] Ibid., which notes "because unrealized losses diminish the ability of banks to sell securities to meet liquidity needs without incurring losses, these unrealized losses can increase liquidity risks and require closer management of contingency funding arrangements." See also Vice Chair for Supervision Michael S. Barr, "The 2023 U.S. Treasury Market Conference" (speech at the 2023 U.S. Treasury Market Conference, November 16, 2023).

[14] See Board of Governors of the Federal Reserve System, Supervision and Regulation Report (Washington: Board of Governors, November 2023), p. 5.

[15] See SR Letter 23-5: Prudent Commercial Real Estate Loan Accommodations.

[16] Vice Chair for Supervision Michael S. Barr, Statement on the Community Reinvestment Act Final Rule, October 24, 2023.