Are Community Banks Important?

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As a Federal Reserve Bank president, I am occasionally asked outrageous questions regarding central banking and commercial banks. "Is the Federal Reserve owned by a European banking cabal?" "How much ownership of the Federal Reserve do the Rockefellers hold?" But over the past few days, the questions have become truly outrageous:

"Will the regional and community bank model survive in the future?" Are community banks important?

"Shouldn't the Federal Reserve supervise only the very largest banks and not community banks?"

What's more, it is particularly bothersome to me that these last two questions are most often asked by individuals who have not been in or know what a community bank does. So let me answer the question.

Whether you are here today representing JP Morgan or the First State Bank of Hometown, Kansas, the answer is the same. When you cut through the fog, there is no question as to the need for and the importance of community banks in our nation's financial system. The maps on the screen behind me show that banks with less than $10 billion in total assets hold substantial market share in much of the United States and hold the majority of deposits in 16 states. Bank subsidiaries of bank holding companies with less than $50 billion hold the majority of deposits in 26 states.

As you can see from these maps, regional and community banks serve local markets, and in turn, support local economic growth. These banks rely on knowing their customer, and managing those relationships to work with borrowers through good times and bad. Regional and community banks are also typically locally owned and managed, which means they have an immediate and vested interest in the success of their local communities.

Yes, regional and community banks also are under pressure from this crisis, and it will be a struggle for them to regain their footing; but, certainly no more so than that for our largest institutions that received significant government support. Commercial real estate will be a drag on earnings for some quarters yet, and there will be bank failures. But this segment of the industry will recover and its model, with its focus on relationship banking, will prosper as the economy recovers and expands.

Interestingly, looking at preliminary data, I suspect future analysis of this crisis will find that regional and community banks during the crisis actually may have done a better job of serving their local markets and maintaining lending standards. While this group of banks has a higher concentration of commercial real estate to capital, there is evidence that they are working effectively, and in some instances, more cooperatively than the largest banks with their borrowers to work out or reduce losses, based on their knowledge and active monitoring of customers.

Some of our largest banks would be well-served to take a lesson.

It is also no coincidence that with breakdowns in other parts of the marketplace, a substantial portion of regional and community banks have increased their loans to businesses. During 2009, 45 percent of the banks with under $1 billion in assets increased their business lending.

And while it may make some of the largest banks uncomfortable to hear this, regional and community banks have managed all this while operating at a competitive disadvantage. For it is the largest financial firms that have an implicit, recently made explicit, guarantee that taxpayer dollars will be used to protect them from failure, regardless of what risks they assume. It is only now that we are discussing legislation to address the issue of a special class of the largest firms that we have deemed too-big-to-fail. This is the one item that must be addressed if we are to have any real competitive equity among all financial institutions. What is proposed may need to be strengthened, but it is a start.

Let me end my remarks by quickly commenting on the Federal Reserve's role as a supervisor of regional and community banks, something that will soon come under debate in the Senate and perhaps again in the House. The strong opposition to removing the Federal Reserve from regional and community bank supervision, voiced by myself and others from the Federal Reserve, is not driven by the idea of simply protecting our "turf" or saving Federal Reserve jobs.

The record very clearly shows that the Federal Reserve System has made important changes to its operations when such moves benefit the country as a whole regardless of the impact on the Federal Reserve. Most notably, the Federal Reserve was among the strongest supporters of Check 21 legislation, while realizing it would mean the eventual loss of thousands of Federal Reserve check processing jobs. The legislation improved the efficiency of our payments system, and while it was painful for me personally to see the elimination of hundreds of jobs in my District, it was a step we had to take to best serve the nation.

In this case, however, serving the best interest of the nation does not mean reducing the Federal Reserve's supervisory role.

Given the importance of 6,800 regional and community banks located in almost as many communities across this country, it is inconceivable to me that the Central Bank of the United States would not have a role in their oversight, through the supervision of state member banks and bank holding companies.

The Federal Reserve System was designed by its founders with the goals of it supervising a broad cross section of U.S. banks, assuring equitable access to the Federal Reserve liquidity facilities regardless of institutional size or location, and contributing to the stability of the financial system – not only on Wall Street but on America's Main Street. It does this job well. In the crisis of the '80s, which affected both large and small banks, banks supervised by the Federal Reserve proportionately imposed the least losses on the FDIC when they failed relative to banks supervised by other Federal agencies.

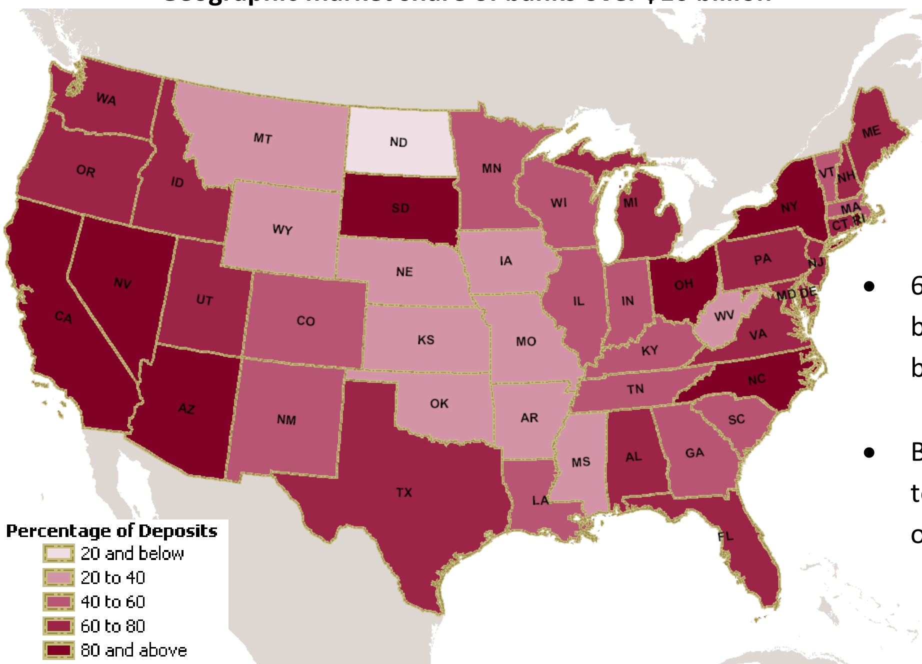
In addition, the Federal Reserve's role in supervision of banks and bank holding companies provides it critical information on local economies in places such as Muskogee, Okla.; Santa Fe, N.M. and Scottsbluff, Neb. And to answer the question: yes, our role in regional and community bank supervision supports our responsibilities as members of the Federal Open Market Committee, by expanding our understanding of local and regional economies.

Stripping the Federal Reserve of its responsibility for supervising regional and community banks and bank holding companies should be unacceptable to anyone who cares about equity in the nation's banking system, largest to smallest bank, and the nation's regional and local economies. Confining the Federal Reserve's supervisory role to only the largest firms will, I fear, inadvertently make the Federal Reserve the Central Bank to the largest firms while disenfranchising the other 6800 banks. The map tells the story.

When Congress created the Federal Reserve nearly a century ago, it gave us a decentralized system that spanned the continent. The explicit purpose for this structure was to better balance the interest of Main Street against those of Wall Street. Recent experience confirms that this structure is as important today as then, perhaps more so. Community banks are important to the banking system and to the economy, and therefore continue to be important to the Federal Reserve. I have said before but it deserves repeating: It would be a tragic irony if the outcome of this crisis is a gain in power for the largest firms at the expense of the other 6,800 regional and community banks. If so, it would be a win for Wall Street.

Geographic Market Share of Banks in the U.S.

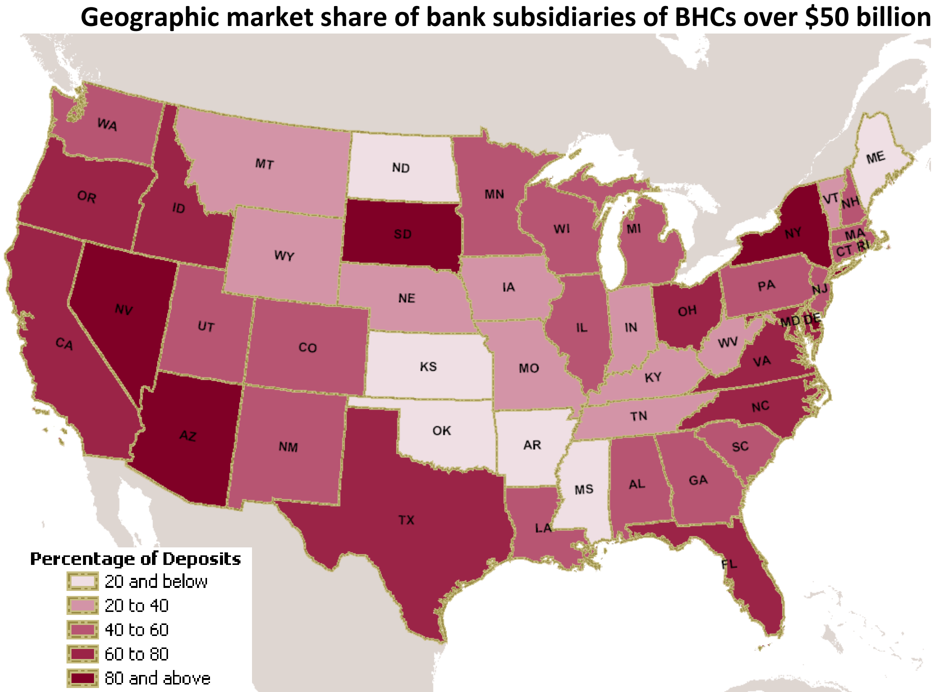
Geographic market share of banks over $10 billion



Source: FDIC Summary of Deposits (June 2009)

- 69% of total deposits are held at banks with greater than $10 billion in total assets.
- Banks with less than $10 billion in total assets make up the majority of deposits in 16 states.

Geographic market share of bank subsidiaries of BHCs over $50 billion



Source: FDIC Summary of Deposits (June 2009)

- 60% of total deposits are held at bank subsidiaries of BHCs with greater than $50 billion in total assets.
- These BHCs own the majority of deposits in 24 states.
- Total assets of the largest BHCs constitute 83% of all BHC assets in the U.S.; however, represent less than 1% of the total population of BHCs.