COMMUNITY BANK REGULATIONS: THE PRESENT AND FUTURE

Banking and the Economy: A Forum for Women in Banking
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**Key Themes**

- Changes in banking structure
- Focus on trend in community banks (CBOs)
- Challenges for CBOs
  - Costs of regulatory compliance
  - Operating in a low interest rate environment
  - Banking in the age of cybersecurity and FinTech
NEW BANKS DECLINE FOLLOWING THE CRISIS

Number of Banks

Source: FDIC Historical Statistics on Banking
COMMUNITY BANKS have seen the largest decline
COMMUNITY BANKS HAVE LED MERGER ACTIVITY

Median Target Asset Size (in millions)*

Number of Mergers


Source: SNL
REGULATION COMPLIANCE COSTS AND CHALLENGES

- While the financial crisis produced new rules and regulations to strengthen the banking sector, they have also increased costs and lowered profits
  - Highlighted by the passage of the Dodd-Frank Act

- Community banks alone spent $4.5 billion in 2014 in compliance costs which could stress their resources and can limit activities

- Recent developments
  - The new administration has called for a pull back on regulation
    - Possible repeal of Dodd-Frank Act
  - Monitoring re-introduction of Financial Choice Act to curtail regulatory burden
Challenges in the Current Interest Rate Environment

- Low interest rates have kept CBO bank earnings and net interest margins subdued

- The extended period of low interest was likely detrimental to the formation of new banks

- Low interest rates create incentives to reach for yield and expose lenders to higher risks when short-term rates rise

- Rate structure has started moving up with increase in December and even if modest, further increases appear to be underway and could accelerate
Effects on Bank Financials in Post-Crisis Environment
RETURN ON AVERAGE ASSETS REMAIN STEADY

SUB S ADJUSTED

% of Avg. Assets

* YTD = Net Income (YTD), as a percentage of average assets - Annualized

Note: Sub S adjusted Net Income

Source: Reports of Condition and Income

All Banks  Banks Over $10B  Banks Under $10B

Federal Reserve Bank of Kansas City
LOW INTEREST RATES HAVE KEPT NET INTEREST MARGINS COMPRESSED

% of Avg. Earning Assets

* YTD = Interest Income Net of Interest Expense (YTD), as a percentage of average earning assets - Annualized
Source: Reports of Condition and Income
Loan growth has been positive since the crisis but lower for CBOs

* YTD = Total Loans minus previous year’s total loan, as a percentage of previous year’s total loans - Annualized
Source: Reports of Condition and Income
But CBOs remain valuable relationship lenders

- **Total Commercial Bank Assets**
  - Under $1 Billion: 7%
  - $1 to $10 Billion: 9%
  - $10 to $50 Billion: 8%
  - Above $50 Billion: 76%

- **Share of Agricultural Loans**
  - Under $1 Billion: 14%
  - $1 to $10 Billion: 20%
  - $10 to $50 Billion: 10%
  - Above $50 Billion: 56%

- **Share of Small Business Loans***
  - Under $1 Billion: 35%
  - $1 to $10 Billion: 21%
  - $10 to $50 Billion: 11%
  - Above $50 Billion: 32%

*Small business lending is defined as net small dollar loans outstanding in the categories of (a) commercial and industrial loans, (b) owner-occupied nonfarm, nonresidential real estate loans, and (c) loans to finance agricultural production, loans secured by farmland, and other loans to farmers.

Source: Reports of Condition and Income, as of December 31, 2016
TECHNOLOGICAL DEMANDS AN IMPORTANT CHALLENGE

FINTECH

SOCIAL MEDIA

CYBER

FEDERAL RESERVE BANK of KANSAS CITY
Development of FinTech

- FinTech represent both potential costs and opportunities to small banks
- FinTech is competing with banks to fill unmet need in demand market
- Banks could partner with FinTech firms to maintain or expand market share
- The OCC may grant special charter for FinTech firms
SOCIAL MEDIA

➢ Can allow banks to meet the new demands created by today’s consumers

➢ Today’s marketplace likely demands more than just a bank website to successfully compete

➢ Challenge in obtaining the right resources and skills to administer a social media strategy
MOBILE BANKING

➢ Increasingly used to access and use banking services

➢ Banks must have the personnel and infrastructure to safely provide such services
Cybersecurity

- Banks are concerned about maintaining and obtaining the necessary resources to fight off cyber attacks
  - Finding IT talent as types of cyberattacks evolve is a top priority
  - The rise in mobile banking use further increases exposure

- This issue can also lead to increased operational risk when strong internal policies are not developed and then followed
CONCLUSION

- Challenges for community banks
  - Costs of regulatory compliance
  - Operating in a low interest rate environment
  - Banking in the age of cybersecurity and FinTech

- However……
  - Community banks are important to local communities and the economy more broadly.
  - Bankers must take on these challenges.
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