

SUPERVISION EMBRACES CHANGES IN TENTH DISTRICT BANKING

—John E. Yorke

Some of the same forces at work in the electronic payments system environment are also present in the financial services industry. Advances in computer and communication technologies are profoundly affecting competition among financial firms. Technology is changing the way banks deliver their services, the services they provide, and the way they manage risk. These changes, coupled with consolidation, are redefining the structure of banking. In turn, the Kansas City Fed is refocusing its supervision of Tenth District financial institutions.

DISTRICT BANKING STRUCTURE SHIFTS

In Tenth District banking, two structural changes are notable—there are fewer banks and fewer large banks. The fall in the number of banks in our district mirrors national merger trends and is largely tied to competitive pressures and the growing cost of technology. The loss of larger institutions reflects the acquisition of large district banks by out-of-district banking organizations—a trend that is likely to continue with full interstate bank branching.

Technology and tougher competition have also caused banks to offer a broader range of financial services and to place more emphasis on non-

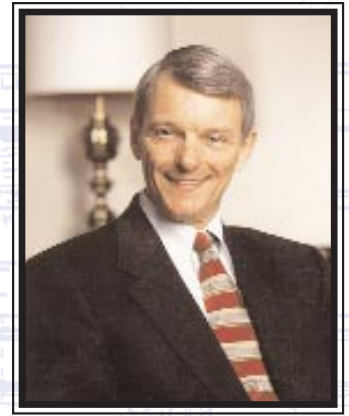
interest revenue sources. Commissions, fees, and service charges on nonloan products are becoming an important revenue source for banks across the country. For example, Tenth District banks are selling mutual funds and insurance, providing customer risk management, and securitizing loans. These trends will surely accelerate if financial modernization bills to expand banking powers become law.

New technologies are also changing the way banks operate. For example, ATMs, telephone services, and Internet banking are cutting costs and delivering financial services more efficiently. And, like banks across the nation, Tenth District banks are managing risk by using financial instruments, simulation models, secondary market sales, and credit scoring models.

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NEW SUPERVISION STRATEGY

The changes in Tenth District banking have required us to strategically adjust the way we operate as well, including the way we supervise banks. With fewer large banking organizations under our jurisdiction, our supervisory practices focus on



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the regional community banks. Facing intense competition, these institutions need new ways to control costs, deliver financial services, and manage risks.

As a regulator, we must allow financial institutions the flexibility to evolve while maintaining a safe and sound banking structure. To accomplish this, we have adjusted our supervisory structure, modified our examination processes, improved our information flows, and sharpened our staff expertise.

One of the reasons the regional Reserve Bank structure has been so successful is that it permits bank supervision to adjust to circumstances occurring in each region. In essence, each Reserve Bank is structured so it can develop an intimate familiarity with the business activities and operating methods of the institutions it supervises.

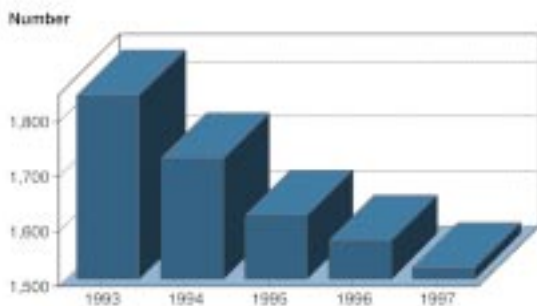
Last year, we made this arrangement even more advantageous to banks and bank holding companies

by dedicating an examiner to each institution. To further enhance our knowledge and service, we grouped our supervisory assignments geographically. This enables our examiners to become uniquely familiar with the environmental factors that influence the performance of the organizations they supervise. This portfolio approach simultaneously allows for more flexibility and individual attention.

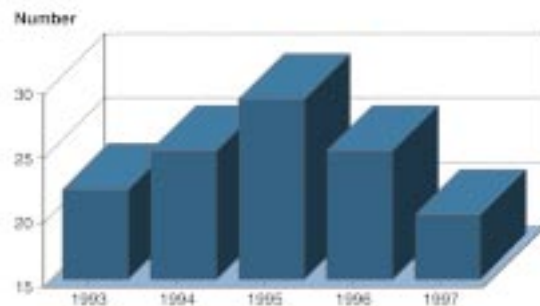
Now that banks are able to operate across state lines and district boundaries, it is increasingly important that we work closely with our fellow regulators to carry out our shared supervisory responsibilities. To that end, we place special emphasis on establishing supervisory arrangements between federal and state regulators, a cooperative structure that makes shared supervision more effective yet more transparent and less of a burden.

Another key supervision strategy change involved re-engineering our examination processes and procedures.

Tenth District Banks



Large Tenth District Banks



Bank mergers, in particular the acquisition of larger banks by out-of-district organizations, has redefined the Tenth District's banking landscape. This is reflective of national trends and is largely tied to competitive pressures and the growing cost of technology.

We conducted an intense internal review, which led to the implementation of a risk-focused examination approach. Because this approach concentrates our efforts on areas of greatest risk, we have become more responsive to the greatest needs of the banks we examine—and less burdensome.

We have also automated our examination process. Information about banks being examined can be in the hands of our examiners almost instantly. And automation gives our examiners the advanced analytical tools they need to understand today's more complex financial transactions and the risks they pose.

As the district's banking environment changes and becomes more complex, small banks are relying on us for advice on regulatory compliance and managing risk. In response, we have stepped up our continuous education program for our supervision staff. For example, we have added courses on leadership dynamics, agriculture, emerging technologies, and, of course, issues affecting the banking industry.

Similarly, we offer more direct help to banks in the form of outreach seminars on regulatory developments, supervisory concerns, bank director responsibilities, and emerging technologies. Through efforts such as these, our goal is to make banks more proficient in self-compliance. Over time, we expect examinations to become even more streamlined, making the process more efficient both for banks and examiners.

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These are some of the environmental factors that continue to redefine the Tenth District's financial services industry. As the industry changes, the Kansas City Federal Reserve will continue to refocus its supervision strategy. As always, our goal is clear: to strike the delicate balance between maintaining a safe and sound banking system and permitting financial institutions the flexibility they need to evolve.

John Yorke is a senior vice president and head of the Division of Bank Supervision and Structure, which is responsible for the supervision and regulation of state member banks and bank holding companies in the Tenth Federal Reserve District. He graduated from the University of Kansas with degrees in accounting and law. He is also a graduate of the Northwestern University Graduate Trust School, the Stanford University Management Program, and the Stonier Graduate School of Banking at Rutgers University.