

COMMUNITY BANK REGULATIONS: THE PRESENT AND FUTURE

Banking and the Economy: A Forum for Women in Banking
Tara Humston, Vice President

March 28, 2017

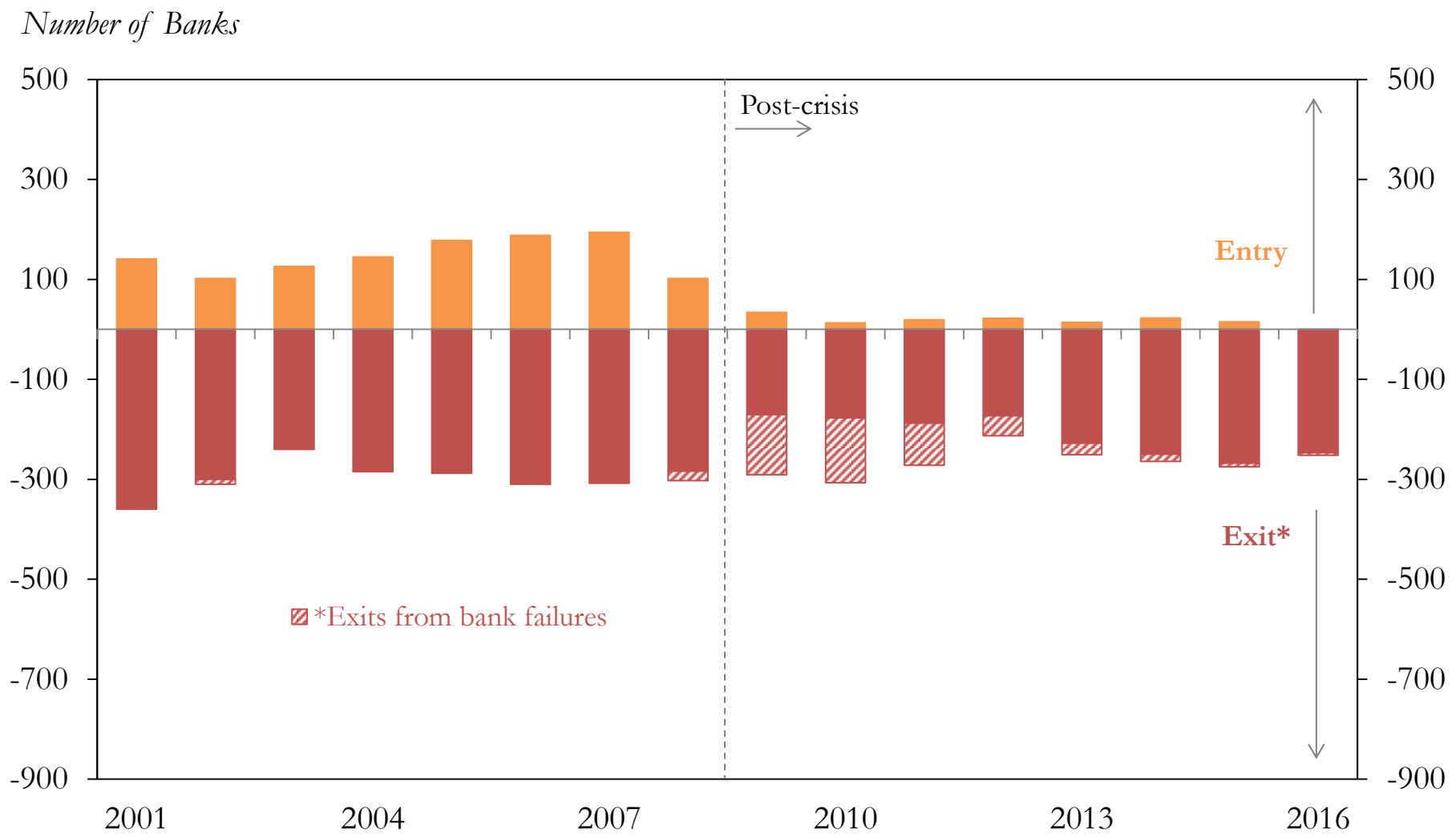


KEY THEMES

- **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**



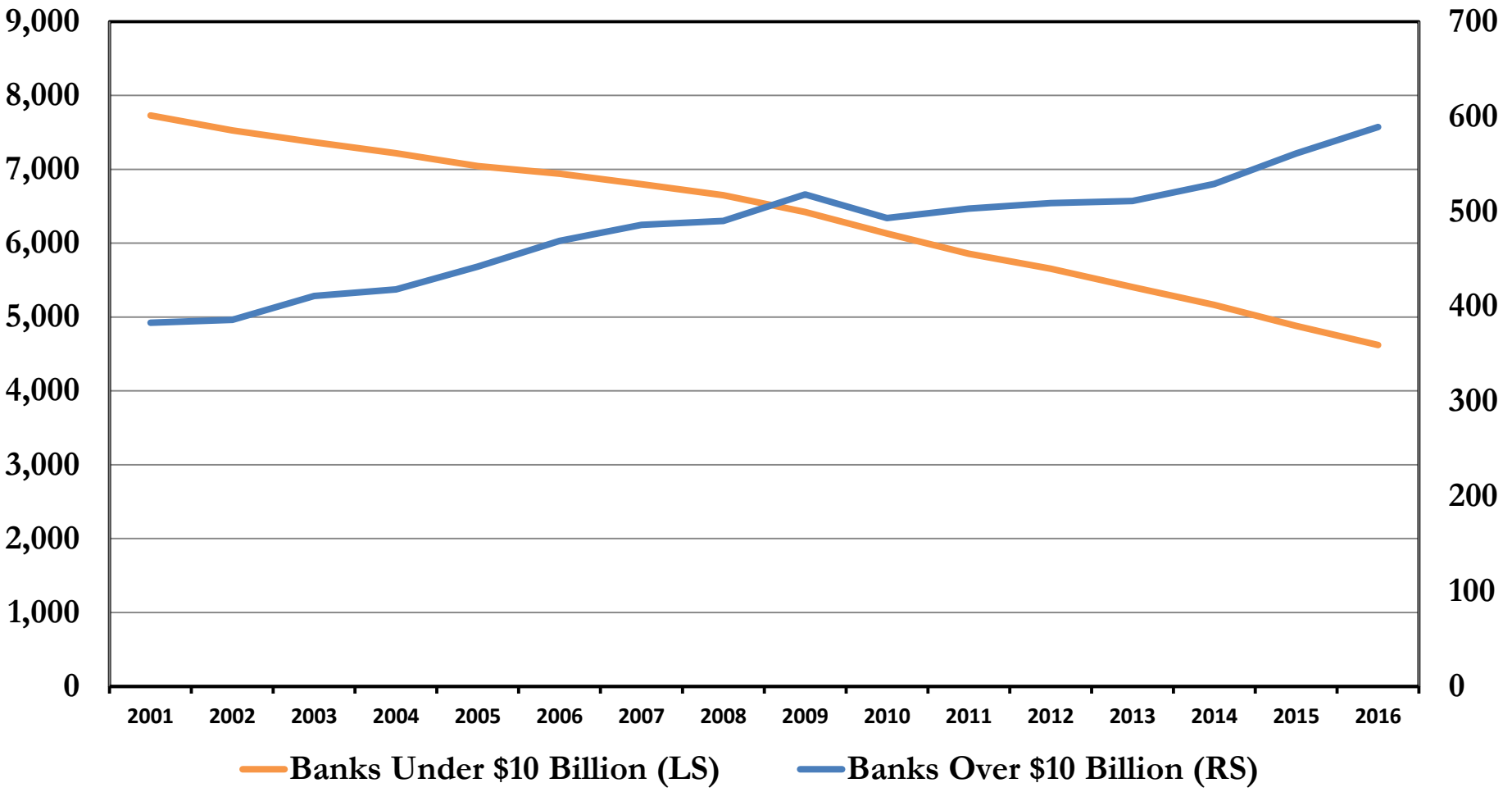
NEW BANKS DECLINE FOLLOWING THE CRISIS



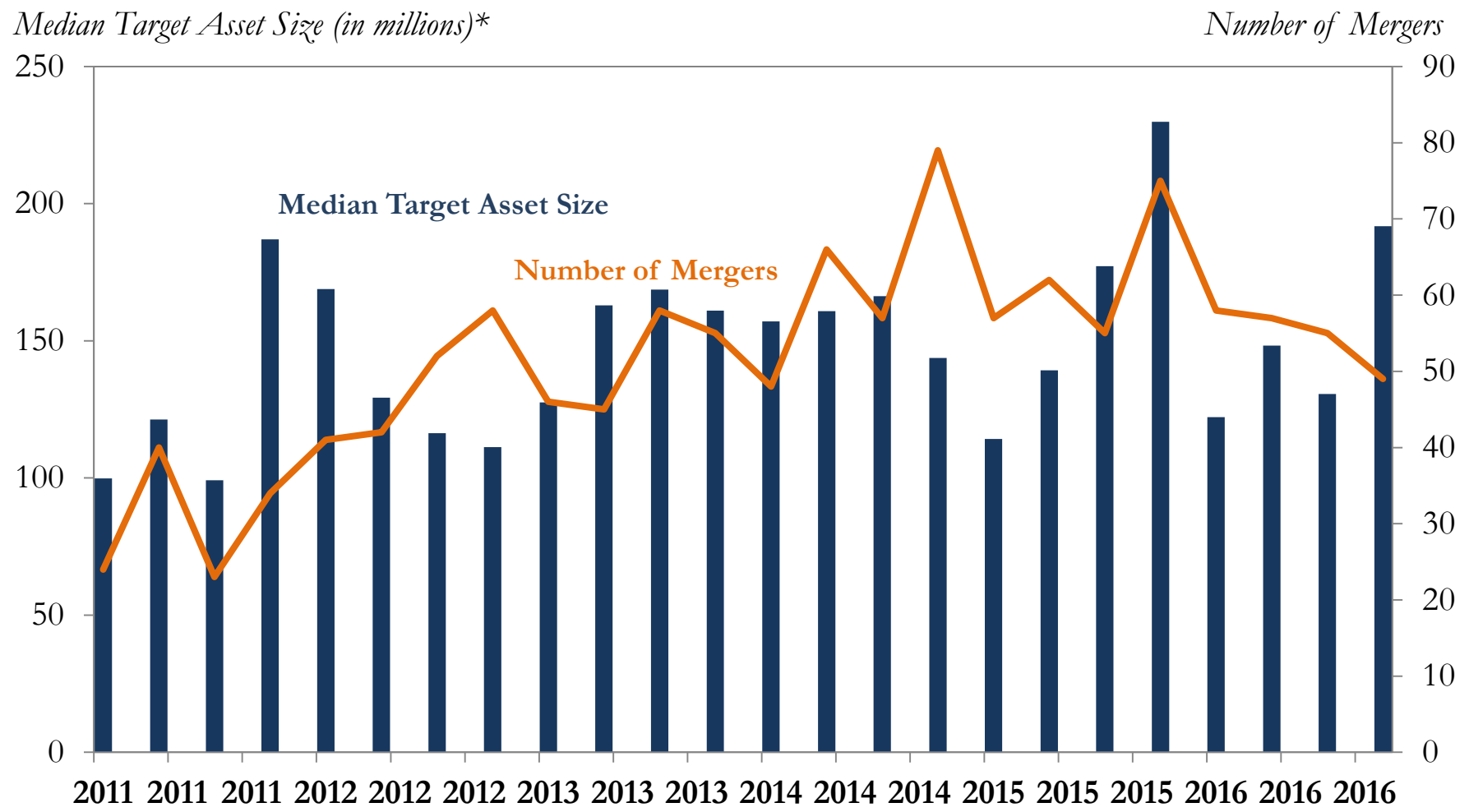
Source: FDIC Historical Statistics on Banking



COMMUNITY BANKS HAVE SEEN THE LARGEST DECLINE



COMMUNITY BANKS HAVE LED MERGER ACTIVITY



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



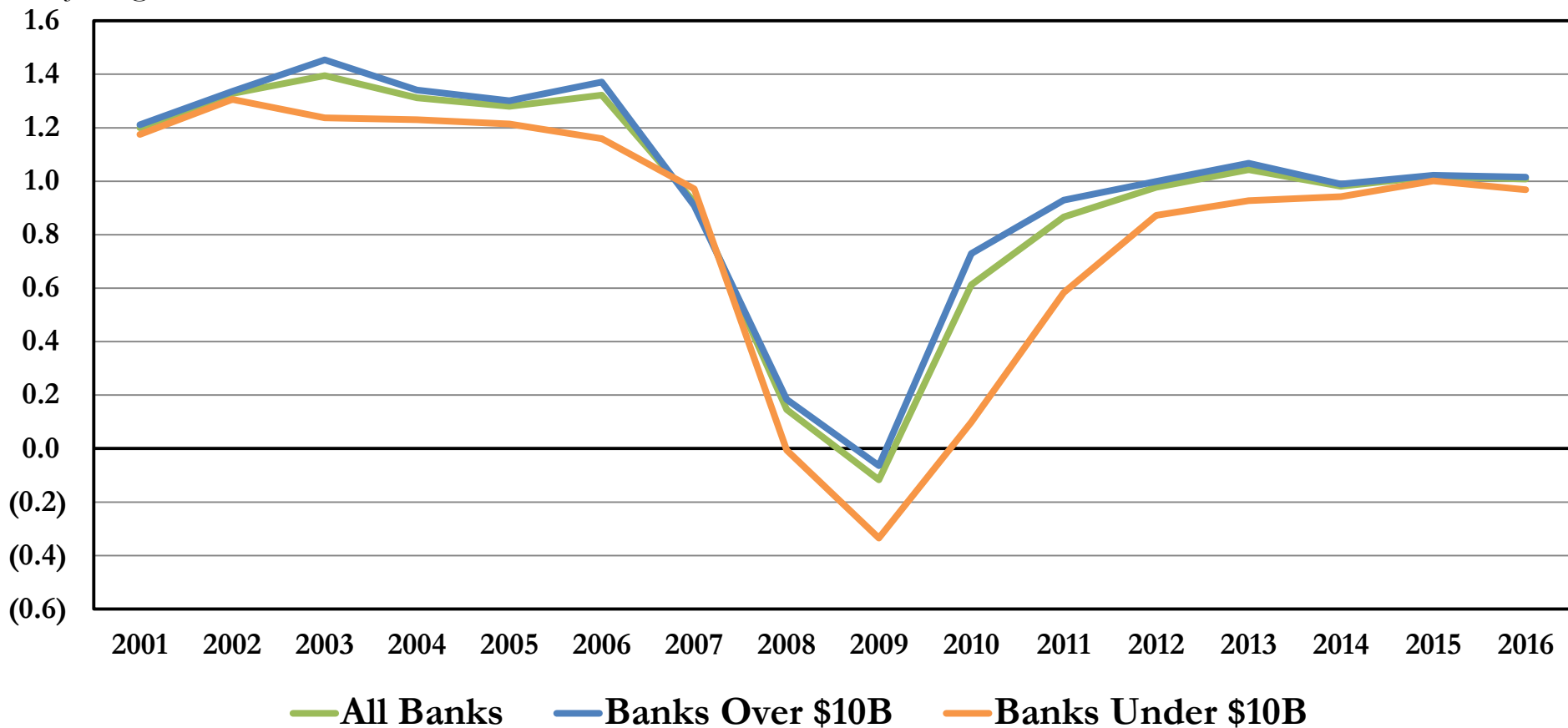
EFFECTS ON BANK FINANCIALS IN POST- CRISIS ENVIRONMENT



RETURN ON AVERAGE ASSETS REMAIN STEADY

SUB S ADJUSTED

% of Avg. Assets



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

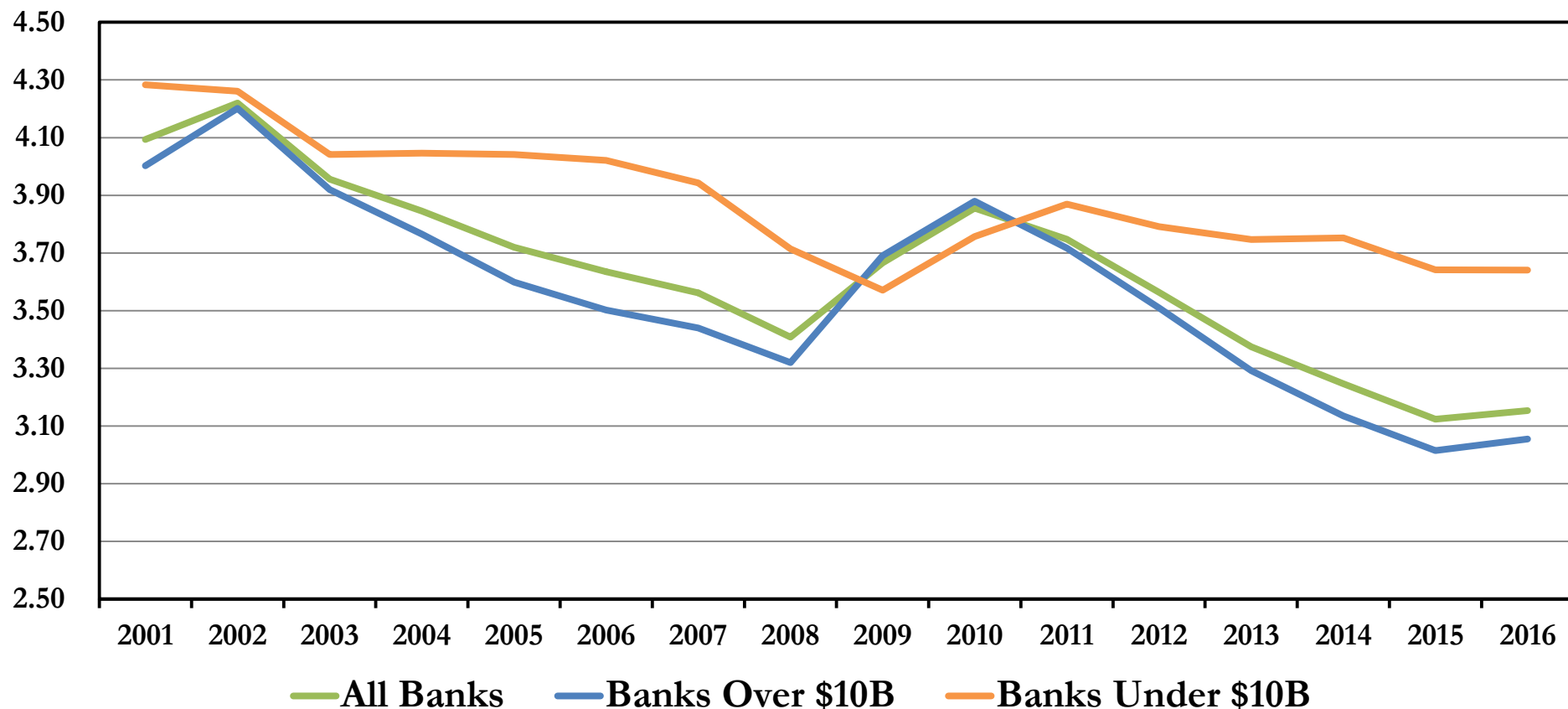
Note: Sub S adjusted Net Income

Source: Reports of Condition and Income



LOW INTEREST RATES HAVE KEPT NET INTEREST MARGINS COMPRESSED

% of Avg. Earning Assets

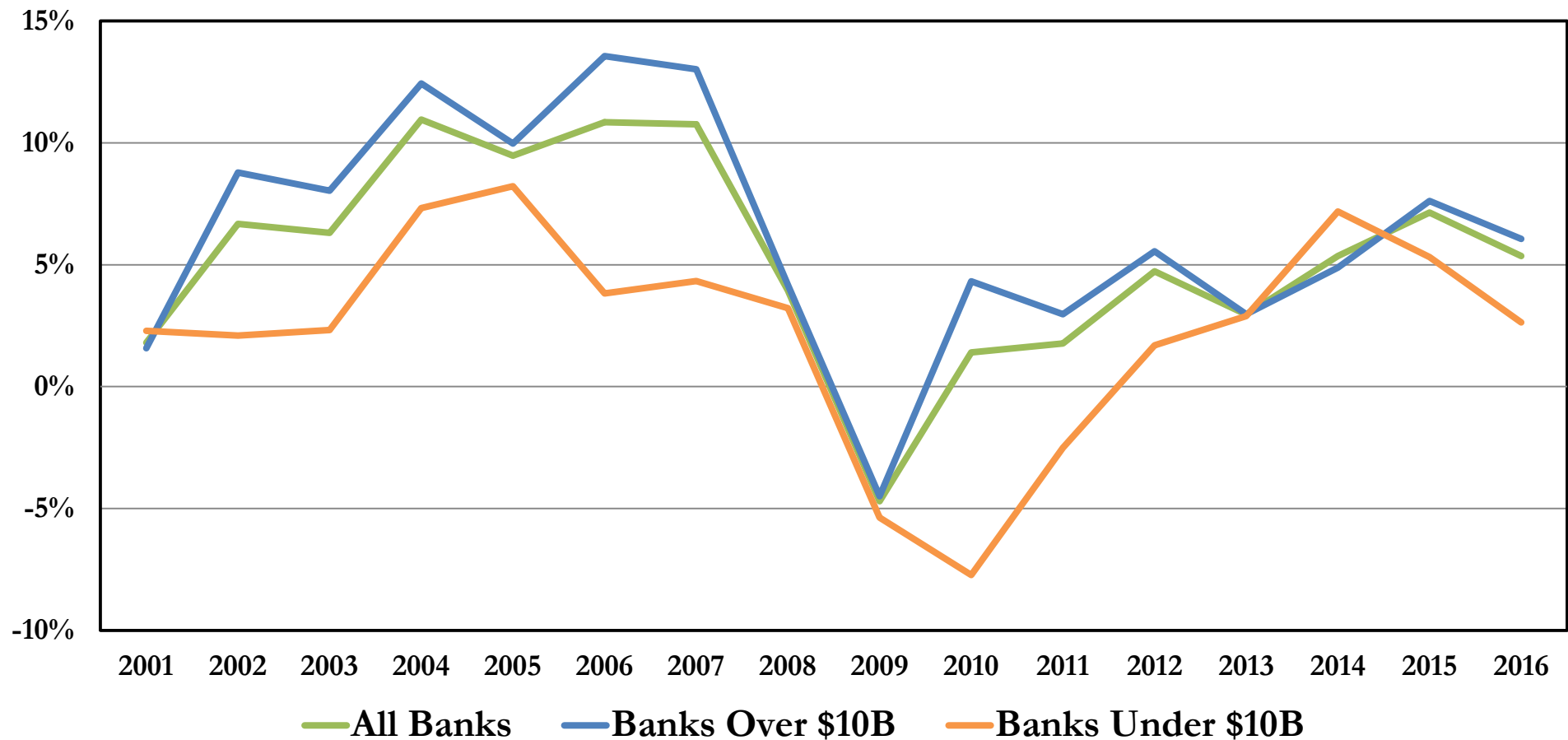


* YTD = Interest Income Net of Interest Expense (YTD), as a percentage of average earning assets - Annualized

Source: Reports of Condition and Income



LOAN GROWTH HAS BEEN POSITIVE SINCE THE CRISIS BUT LOWER FOR CBOs

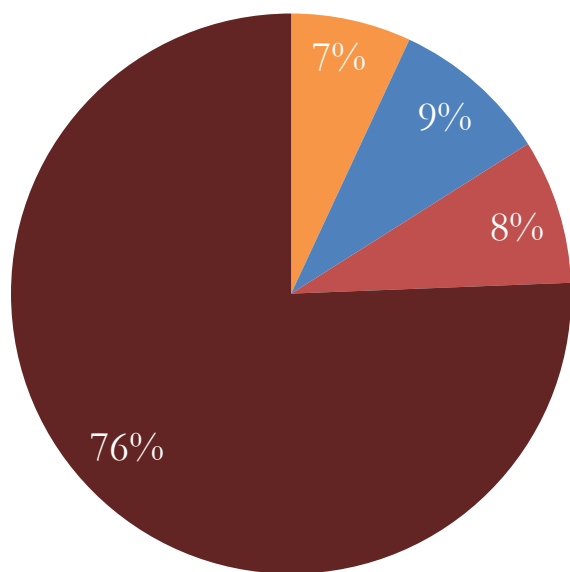


* YTD = Total Loans minus previous year's total loan, as a percentage of previous year's total loans- Annualized
 Source: Reports of Condition and Income

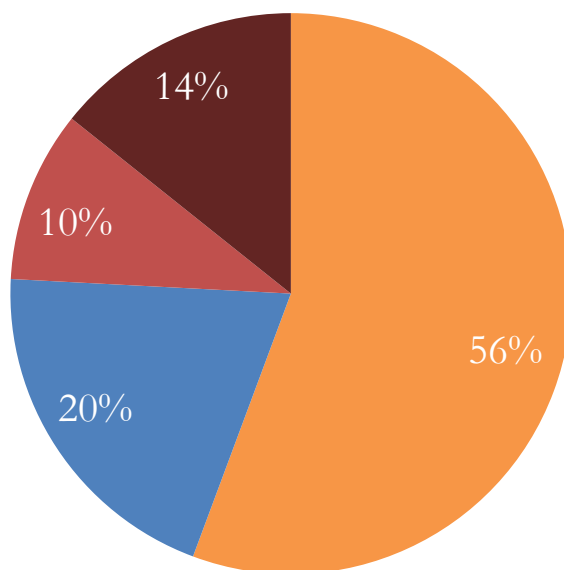


BUT CBOs REMAIN VALUABLE RELATIONSHIP LENDERS

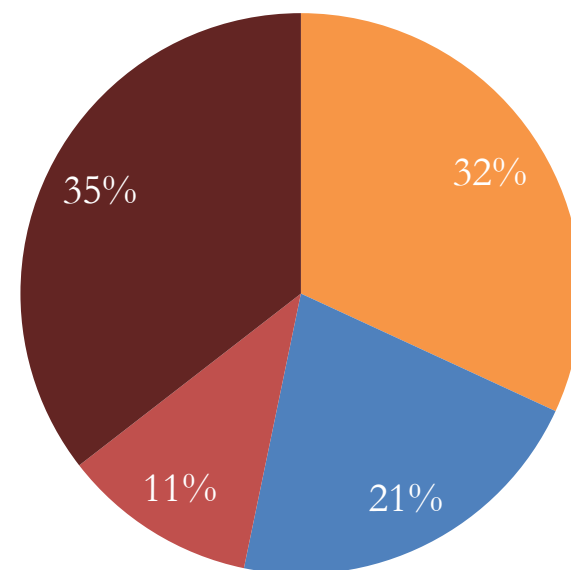
Total Commercial Bank Assets



Share of Agricultural Loans



Share of Small Business Loans*



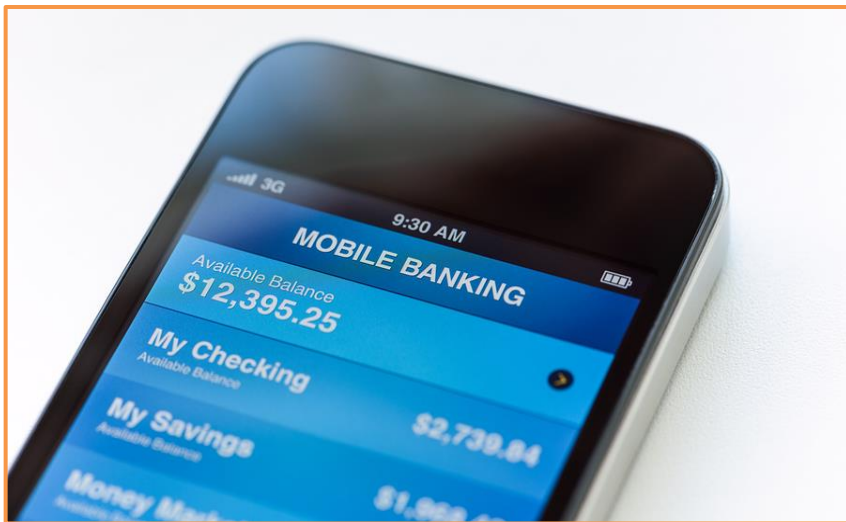
■ Under \$1 Billion
 ■ \$1 to \$10 Billion
 ■ \$10 to \$50 Billion
 ■ Above \$50 Billion

**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



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.



QUESTIONS?

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