

# A SUPERVISORY VIEW ON COMMUNITY BANKING

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# OVERVIEW

## Recent Performance and Condition

- Progress in Addressing Financial Crisis
- Trends in Problem Banks
- Challenges to Returning to Historic Performance Levels

## Supervisory Priorities for 2013

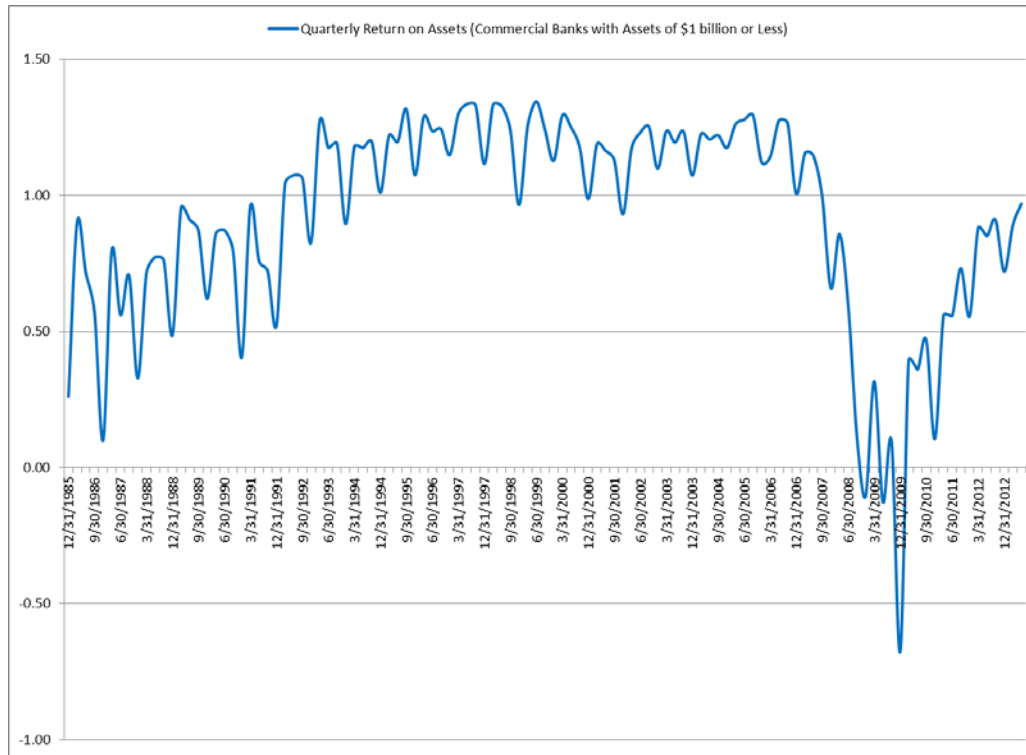
Federal Reserve Efforts to Improve its Community Bank Supervision Program



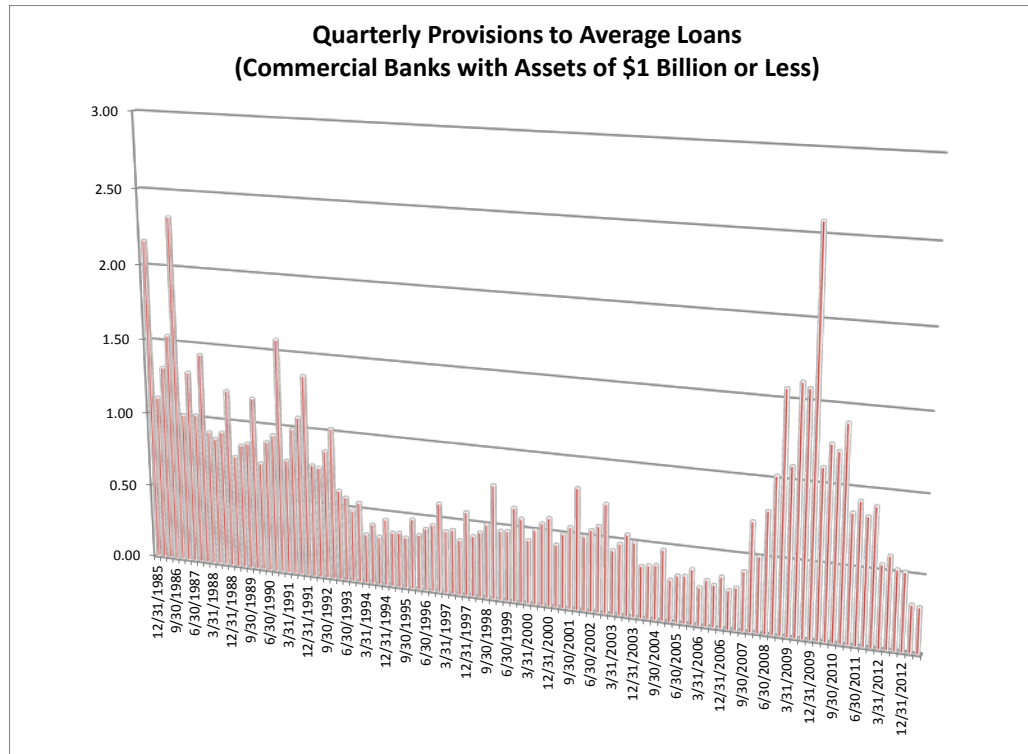
**COMMUNITY BANK  
PERFORMANCE AND CONDITION  
ARE IMPROVING**

STATISTICS FROM CALL REPORTS AND UNIFORM BANK  
PERFORMANCE REPORTS

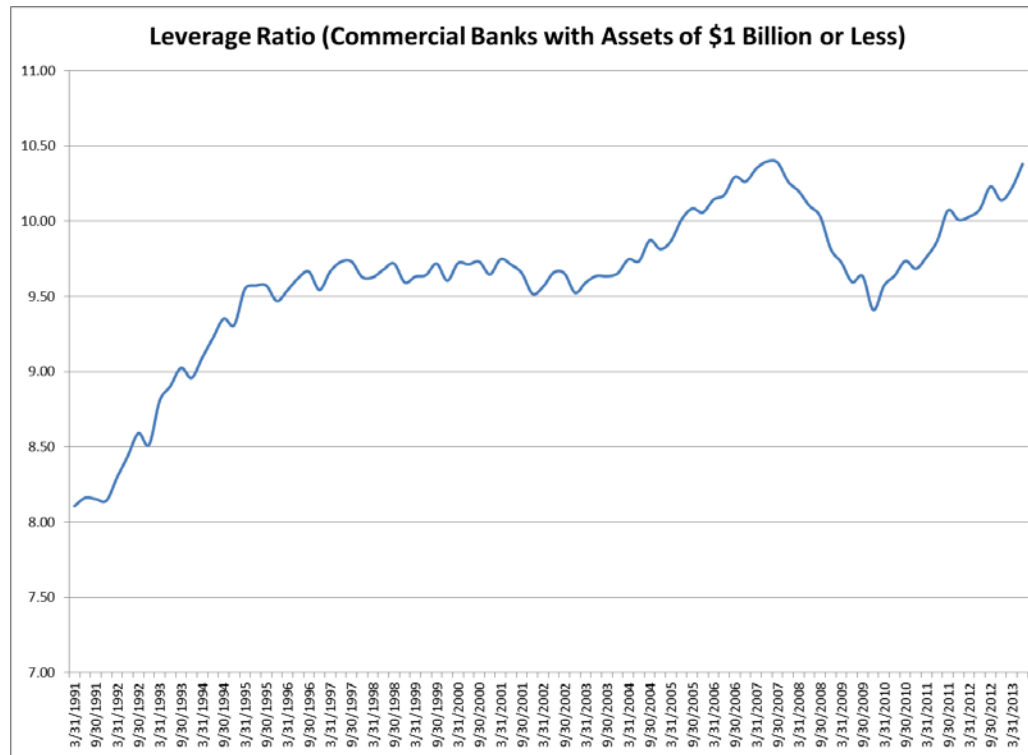
# PROFITABILITY IS STEADILY RISING



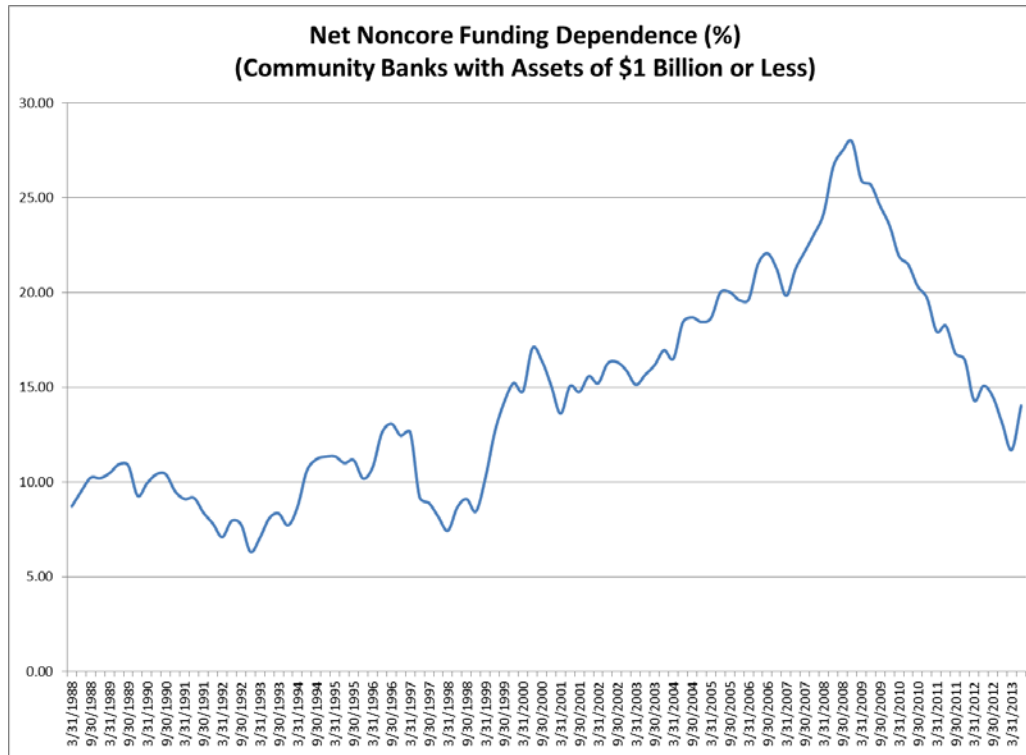
# LOWER PROVISIONS ARE LIFTING EARNINGS



# CAPITAL RATIOS HAVE BEEN MOVING HIGHER



# LIQUIDITY POSITIONS HAVE IMPROVED

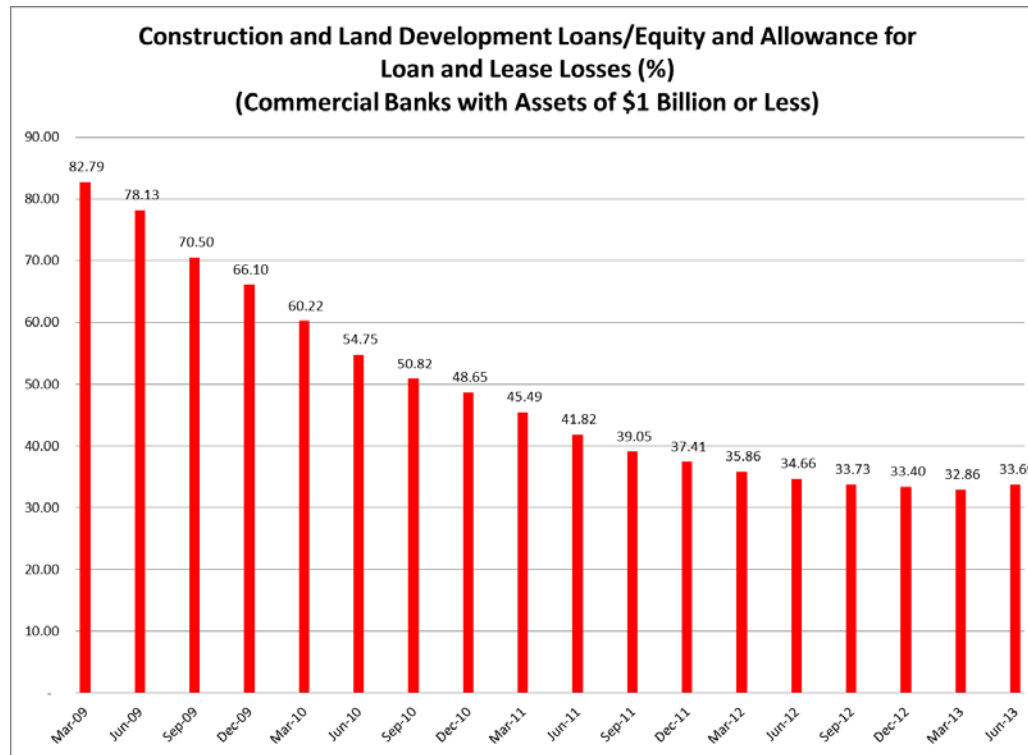


# **COMMUNITY BANKS**

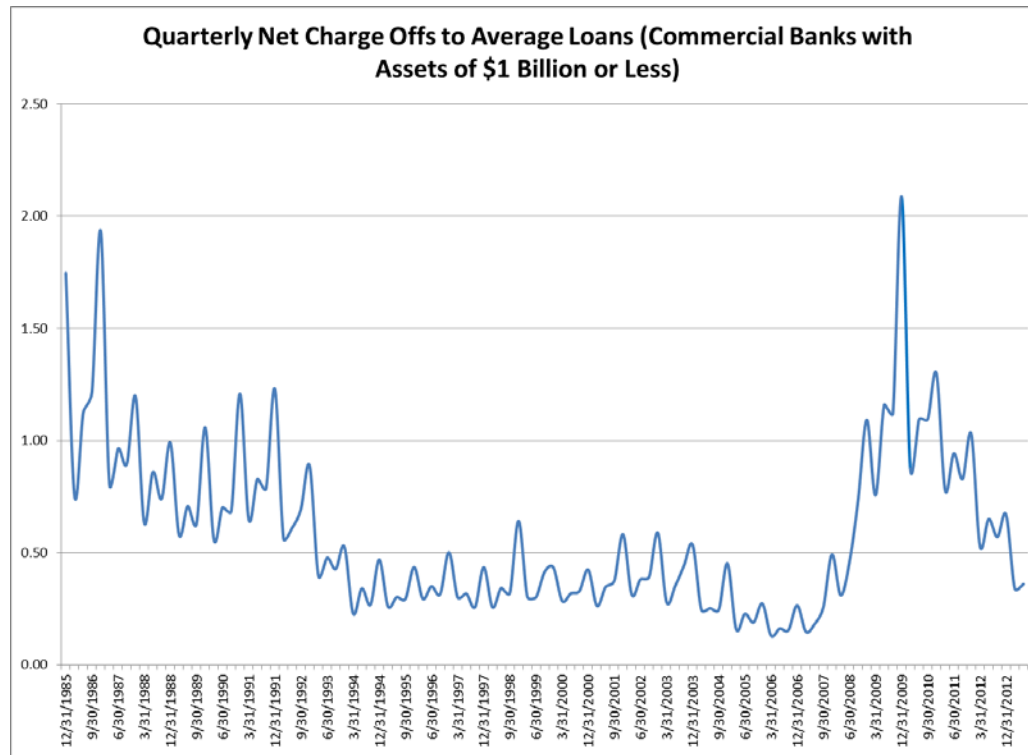
HAVE TAKEN STEPS TO ADDRESS THE CRISIS



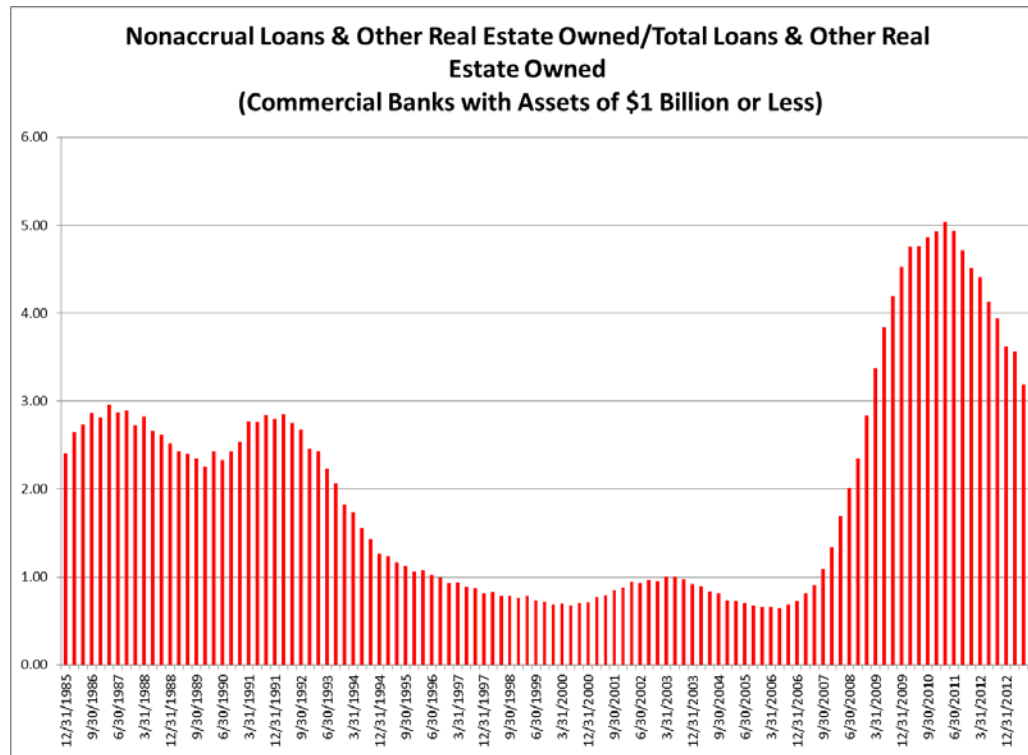
# CONSTRUCTION LOAN CONCENTRATIONS ARE DOWN



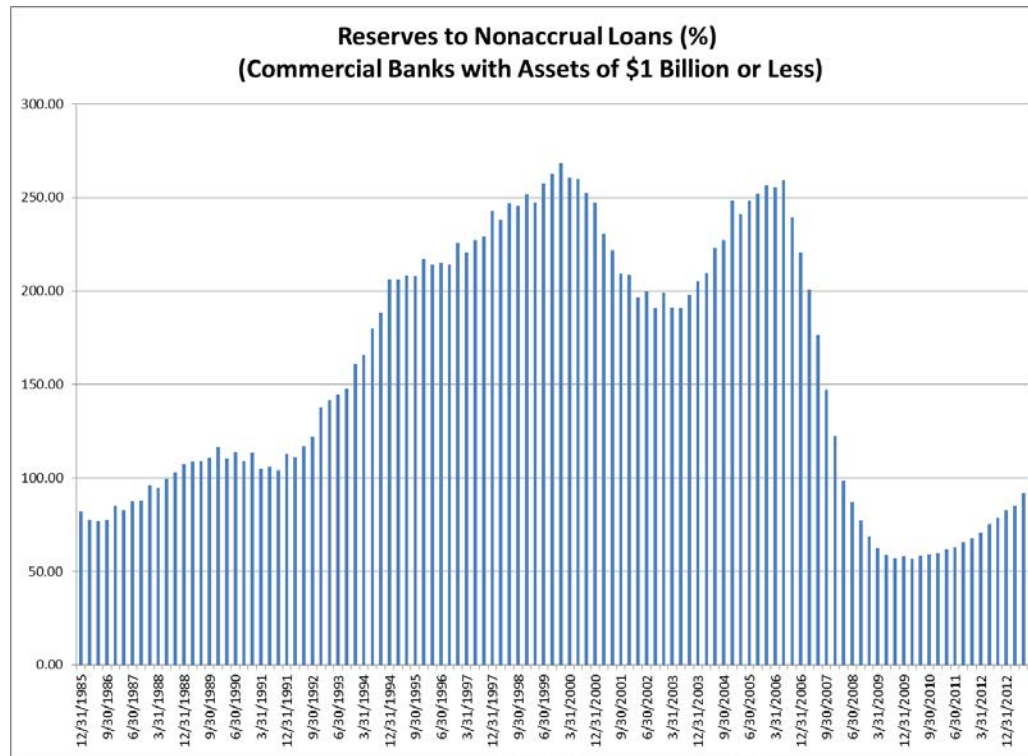
# IN PART DUE TO SIGNIFICANT CHARGE-OFFS



# BANKS ARE WORKING TO REDUCE PROBLEM ASSETS



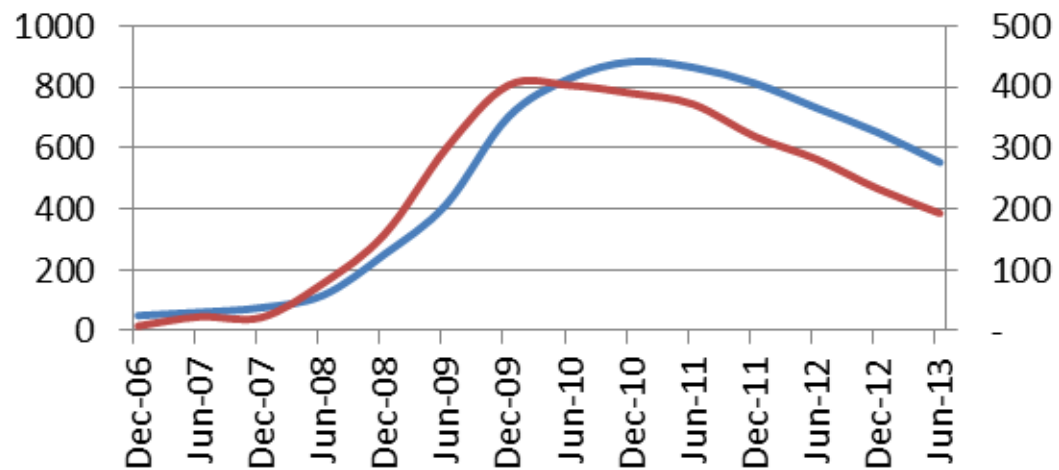
# AND RESERVE COVERAGE IS BENEFITTING



**THE NUMBER OF PROBLEM  
BANKS  
IS DECLINING**

# BUT REMAINS HIGH

(Banks and Thrifts included on the FDIC Problem Bank List)

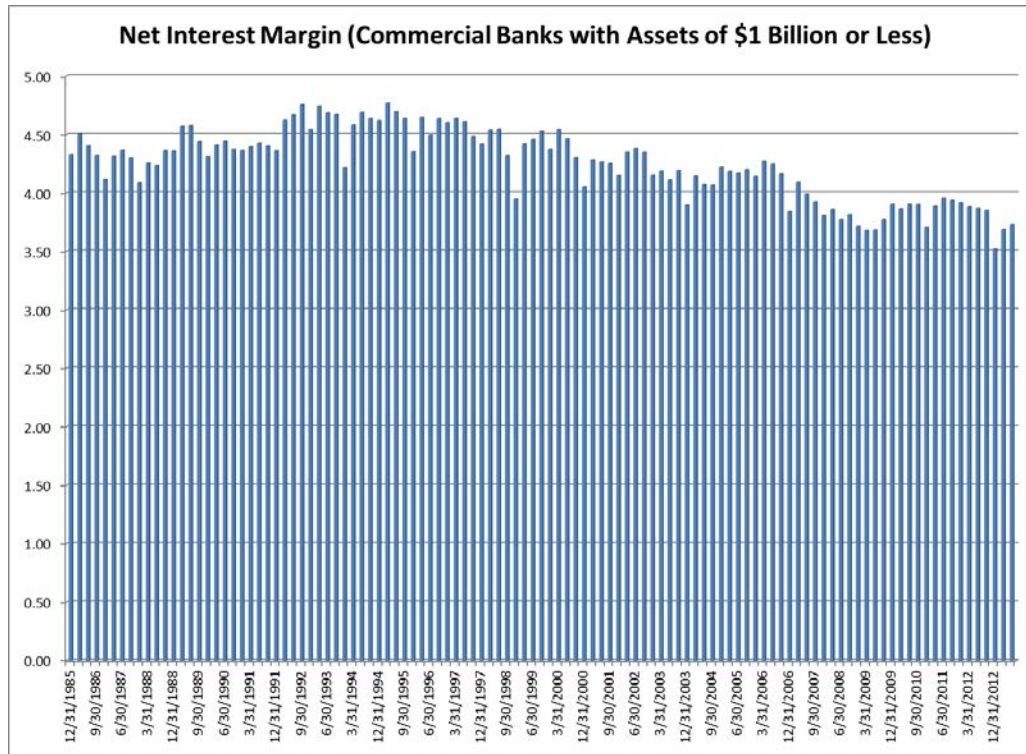


	Dec-06	Jun-07	Dec-07	Jun-08	Dec-08	Jun-09	Dec-09	Jun-10	Dec-10	Jun-11	Dec-11	Jun-12	Dec-12	Jun-13
Number (left axis)	50	61	76	117	252	416	702	829	884	865	813	732	651	553
Assets \$B (right axis)	8	23	22	78	159	300	403	403	390	372	319	282	233	193

Source: FDIC Quarterly Banking Profile

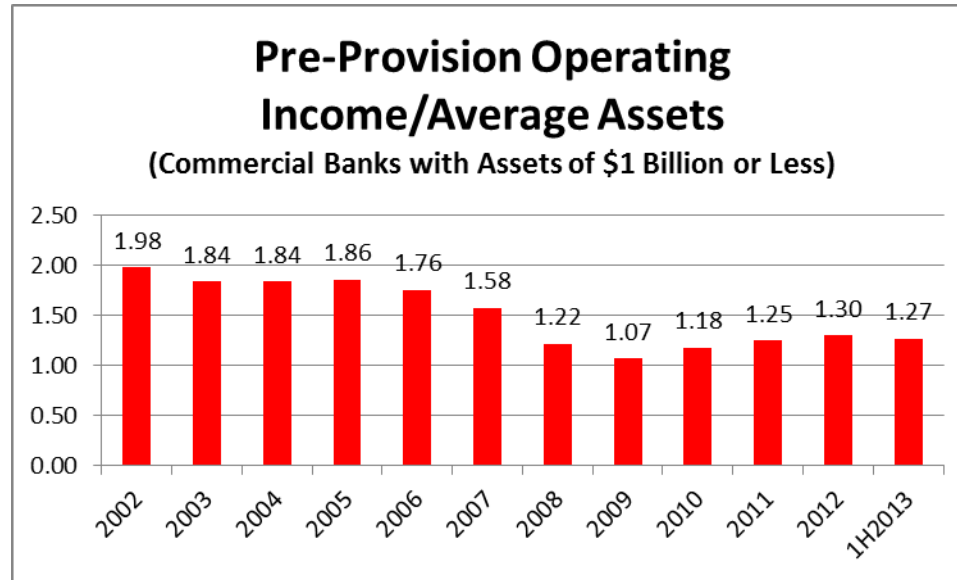
**CHALLENGES REMAIN**

# MARGINS ARE TIGHTER



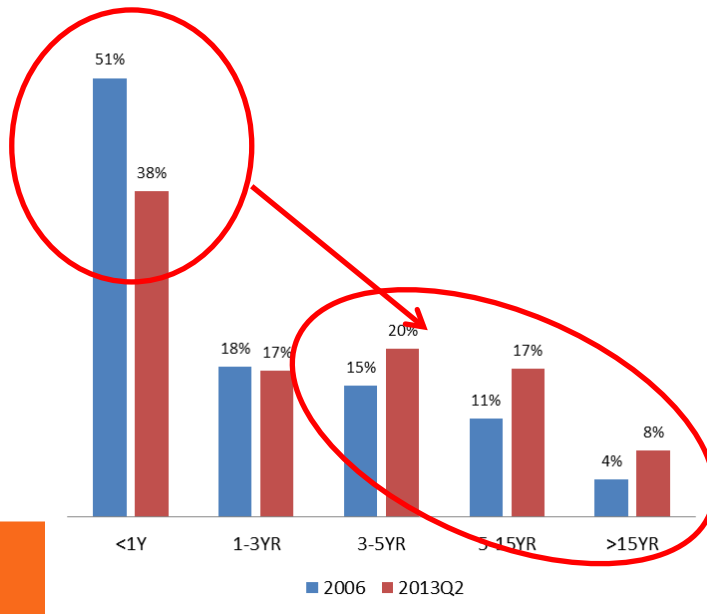


# PRE-PROVISION OPERATING INCOME IS STILL LOWER

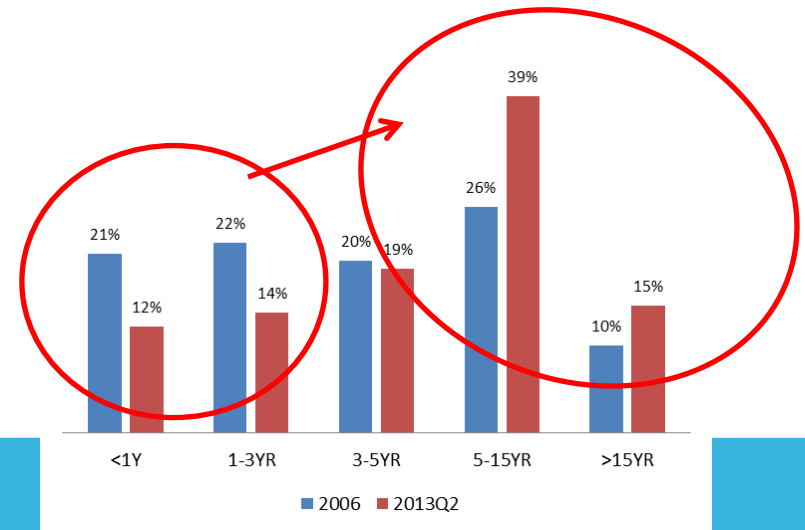


# BANKS MAY BE BOOSTING PERFORMANCE BY TAKING ON INTEREST RATE RISK: ASSET MATURITIES HAVE LENGTHENED...

**Loan Portfolio Only:  
Percent of Assets Repricing**

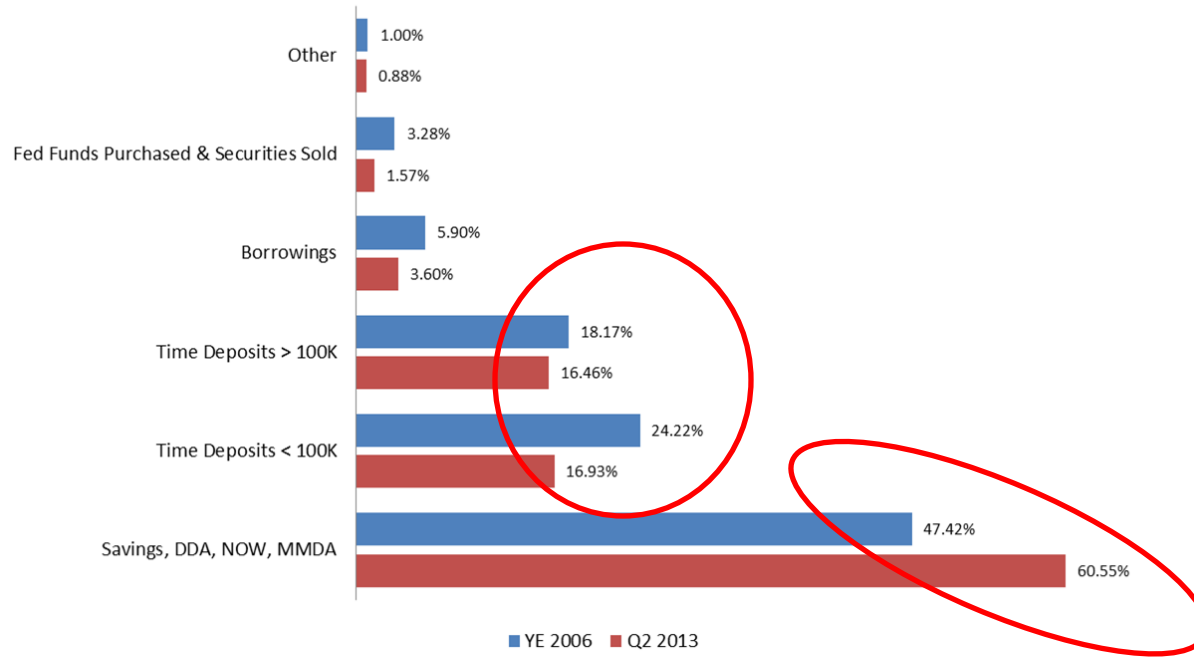


**Securities Portfolio Only:  
Percent of Assets Repricing**

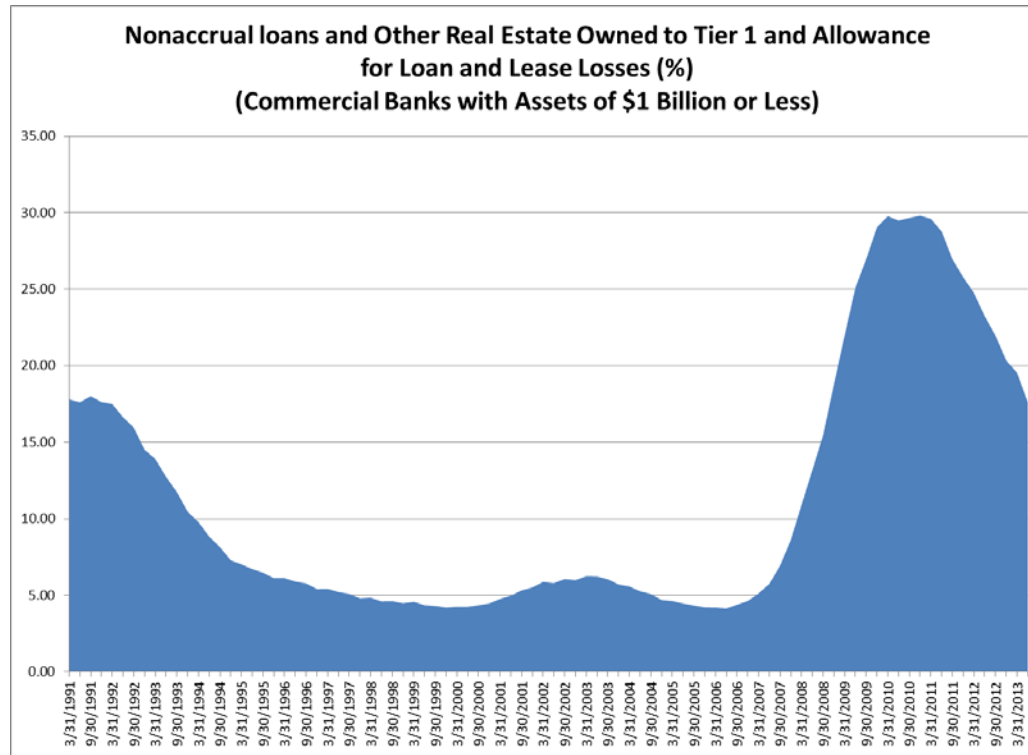


# BANKS MAY BE BOOSTING PERFORMANCE BY TAKING ON INTEREST RATE RISK: ...WHILE DEPOSIT MATURITIES HAVE SHORTENED.

Liabilities Mix



# CAPITAL IS STILL STRAINED BY AQ WEAKNESSES



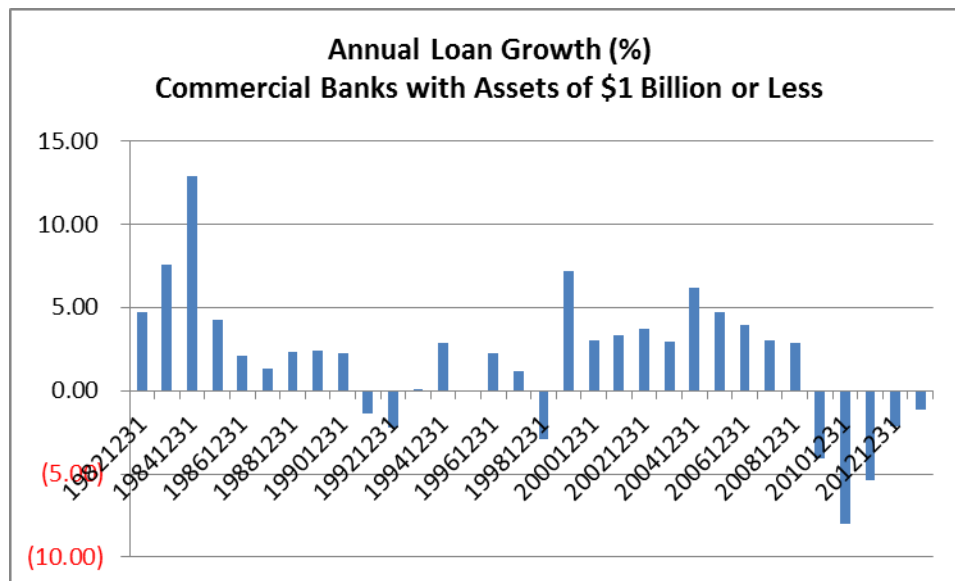
# AFFECTING MANY COMMUNITY BANKS

$(\text{Restructured} + \text{Nonaccruing} + \text{OREO}) / (\text{Equity Capital} + \text{ALLL})$

	10th Pct	25th Pct.	Median	75th Pct.	90th Pct.
2006	-	0.21	2.35	6.74	13.62
2009	0.29	4.06	13.80	32.74	70.49
2012	0.50	4.06	12.67	28.98	57.97
1H2013	0.49	3.88	12.05	26.86	52.27

SOURCE: UBPR DATA FOR COMMERCIAL BANKS UNDER \$1 BILLION

# LENDING HAS STILL NOT RECOVERED FOR COMMUNITY BANKS AS A GROUP





# **SUPERVISORY PRIORITIES**

# AREAS OF FOCUS REFLECT CURRENT CONDITIONS

In view of overhang of problem assets, we continue to focus on assessing the quality of loan portfolios and the adequacy of reserves.

Examiners are focusing on ensuring that banks are effectively managing interest rate and credit risks as they seek to enhance earnings.

For banks entering new lines of business, examiners will also be testing to ensure that banks have fully evaluated the potential risks of new business lines and put appropriate risk management structures in place to mitigate these risks before entering the new line.





# **EFFORTS TO IMPROVE**

FEDERAL RESERVE SUPERVISORY PROGRAM FOR COMMUNITY BANKS

# **WE HAVE ENHANCED THE FOCUS ON COMMUNITY BANKS**

In 2009, the Board established a subcommittee to focus on supervisory approaches to community and regional banks.

In 2011, the Board established the Community Depository Institutions Advisory Council (CDIAC) to provide input on the economy, lending conditions, and other issues of interest to community banks.



# FEEDBACK HIGHLIGHTS REGULATORY BURDEN

Community bankers persistently flag increasing regulatory burden as a concern and threat to the viability of the community bank model

As a result, the Board's subcommittee on community and regional banks started a number of initiatives to clarify regulatory expectations, alleviate regulatory burdens where possible, and reduce the potential that regulatory actions could curtail lending.



# **SEVERAL PROJECTS HAVE BEEN COMPLETED TO IMPROVE OR CLARIFY GUIDANCE**

Marking Guidance that applies to Community Banks (Started October 2011)

Reiterated guidance on when upgrades should be considered for community banks  
(SR 12-4)

Enhanced internal procedures to improve the transparency of ALLL assessments

In conjunction with the other agencies, we clarified capital planning and stress testing expectations for community banks (SR 12-7)

Evaluated applications processing procedures to identify streamlining opportunities and made changes to enhance transparency (SR 12-12)

Clarified exam preparation procedures to ensure that reports are timely and findings are clearly and consistently communicated (SR 13-14)



# WE ARE ALSO EXPLORING IMPROVEMENTS TO EXAMINATION PROCESSES

Developing and adopting common technology tools across the Federal Reserve to improve efficiency and reduce burden on supervised companies

Evaluating completion of more examination work off-site

- Using technology to complete loan file reviews
- Seeking ways to better utilize financial information collected from banks to tailor on-site procedures



# AND WE ARE LOOKING TO ADD VALUE TO OUR INDUSTRY TRAINING

A major goal is to do a better job explaining supervisory expectations to small banks

In addition to formal policy releases, we are now using periodic newsletters highlighting the information that banks “need to know,” special publications that provide information on how examiners will assess compliance, and occasional training sessions to address new regulations or areas of particular concern



# NEW COMMUNICATION TOOLS INCLUDE:

## Ask the Fed

- [www.stlouisfed.org/BSR/askthefed/public-users/login.aspx?ReturnUrl=%2Fbsr%2Faskthefed%2Fdefault.aspx](http://www.stlouisfed.org/BSR/askthefed/public-users/login.aspx?ReturnUrl=%2Fbsr%2Faskthefed%2Fdefault.aspx)

## Community Banking Connections

- [www.communitybankingconnections.org](http://www.communitybankingconnections.org)

## FedLinks

- [www.communitybankingconnections.org/fedlinks.cfm](http://www.communitybankingconnections.org/fedlinks.cfm)

# ASK THE FED

Ask the Fed was introduced in 2008 to provide timely updates on emerging and important topics

The program hosts teleconference call-ins for banking executive-level officials and boards of directors

**Recent Sessions have addressed:**

- Cybersecurity and Malware: What Bankers Need to Know
- Back to Basics: Sections 23A and B of the Federal Reserve Act/Regulation W
- Interagency Guidance on Leveraged Lending
- Revised Regulatory Capital Framework – Final Rules
- [Bank] Accounting Hot Topics




# COMMUNITY BANKING CONNECTIONS

Established in 2012, Community Banking Connections is a website and quarterly on-line newsletter for community banks

**Its objectives are to:**

- Clarify key supervisory guidance
- Highlight new regulations
- Provide perspectives from bank examiners and Federal Reserve staff
- Address challenges and concerns facing community banks and provide resources to assist them

**Recent newsletters have addressed:**


- Considerations when Introducing new Products and Services
  - Effective Asset/Liability Management
  - Investing in Securities without relying solely on external credit ratings
- 

# FEDLINKS

***FedLinks*** articles were initiated in late 2012. These articles:

- Discuss supervisory topics that are important to community banks
- Highlight the purpose of related supervisory policy and guidance
- Use examples and illustrations to demonstrate the practical application of covered topics
- Provide integrated summaries that describe how examiners typically will address the covered topics

***FedLinks*** Topics addressed to date:

- Risk management and supervisory expectations for agricultural credit risk
  - Allowance for Loan and Lease Losses
  - Supervisory Expectations for Internal Controls
  - Supervisory Expectations for Appraisal and Evaluation Programs
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# WE VALUE AND RESPOND TO FEEDBACK

We rely on feedback from community banks to inform our development of effective, but burden sensitive, supervisory procedures

We are developing more materials for community banks to better help bankers focus on what they need to know

We are expanding our efforts to understand challenges facing community banks; for example, by hosting a community banking research conference, in conjunction with the Conference of State Bank Supervisors, in St .Louis

Our goal is to ensure a rigorous, but balanced, approach to supervision that fosters a stable, sound, and vigorous community bank population

