

Fed Takes More Steps to Ease Burden on Smaller Banks

By Donna Borak, American Banker, JAN 13, 2012

WASHINGTON — A top Federal Reserve official said Friday the central bank will soon take steps to alleviate the regulatory burden on community banks as they sift through thousands of pages of new rules.

Fed Gov. Elizabeth Duke said the central bank will be employing a strategy that will list exactly what firms will be affected by each rule under Dodd-Frank.

"We are now working to include, at the beginning of each regulatory proposal, final rule, or regulatory guidance, a statement outlining which banks are affected," Duke said in a speech before the California Bankers Association.

When issuing supervisory letters, she said, the Fed will try to state specifically if and how new regulations will apply to community banks. "This way, banks won't waste resources on requirements that don't apply to them," she added.

In cases where rules apply to all banks, but application would vary based on the size or the degree to which firms participate in certain activities, the Fed will make distinctions throughout the regulation or guidance, she said.

The Fed will be also be using examples to help clarify supervisory expectations as it did in 2009 when it offered several examples of loan restructurings and how that would be classified under its workouts of commercial real estate.

"I believe bankers come to fully understand supervisory expectations over time, as their experience grows," said Duke. "But when something radically changes the supervisory landscape such as new regulations, drastic changes in the economic environment, or reassignment of regulatory authority, more direct outreach might be needed."

Reminiscing about her own days as a community banker, she assured bankers that, even as regulator, she still reads every rule, guidance and proposal with the understanding that alone is another burden.

"I still remember the experience as a banker reading through hundreds of pages of dense language, paying close attention to the footnotes, trying to determine whether a regulation even applied to my bank and, if it did, what was expected of us," said Duke.

That didn't include the effort to figure out how the bank would meet the requirements, or what the costs would be to comply with the new rule, she noted.

She stressed that regulators, including the Fed, should avoid a "one-size-fits-all approach" in crafting new regulations under Dodd-Frank.

"The disproportionate cost of regulatory compliance for smaller institutions is real," said Duke. "Financial supervisors must be vigilant in efforts to maintain financial system stability and ensure that consumers are able to understand their financial product choices, no matter where they should to bank."

The Fed formed a subcommittee, chaired by Duke, to oversee supervision of community and small regional bank firms.

According to Duke, a large regulatory burden on community banks is mortgage lending. That authority has now shifted the Consumer Financial Protection Bureau created under Dodd-Frank.

Community banks typically hold these loans on their balance sheets, rather than have them securitized like their larger counterparts. That means community banks end up retaining "100% of the credit risk of these loans and have no incentive to make loans without regard to the consumer's ability to pay," said Duke.

"I think it would be unfortunate if the laws and regulations put in place to require other lenders to adopt the same responsible practices long used by community banks are so complicated and expensive that they have the unintended effect of forcing some community banks to leave the market," said Duke.

Dodd-Frank already makes exemptions for banks in rural or underserved areas, but Duke said broader exemptions could be warranted for the thousands of smaller banks that make loans in small metropolitan areas or suburban areas.