FEDERAL RESERVE SYSTEM

COMMUNITY BANKING

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A Message from Governor Bowman

by Governor Michelle W. Bowman

First Issue 2022

Governor Michelle W. Bowman

Since this is the first *Community Banking Connections* issue of 2022, I wanted to share with you a few thoughts on the state of the overall economy and the community banking sector. As I write this letter in February, I am pleased to note that community banks entered the pandemic in sound condition, played an important role in channeling emergency lending to keep local businesses open, and have remained well capitalized and able to maintain lending to their customers during the recovery. That recovery has continued despite the recent Omicron-related surge in infections. While there are still risks and lingering uncertainty, indications are that we will have another year of strong economic growth. Even with strong growth, I expect some bumps along the path to normal economic activity and public policy. These bumps include the ongoing and likely longer-term effects of bottlenecks on supply chains, which could limit economic activity and push prices higher.

Inflation is a significant problem for families and businesses. As of February, reports showed the highest U.S. inflation readings in 40 years. These reports reflect, in part, supply chain disruptions associated with the economic effects of the pandemic. Unfortunately, supply-side issues cannot be effectively addressed by monetary policy. But strong demand and a very tight labor market have also contributed to inflation pressures, and the Federal Reserve can help alleviate those pressures by removing extraordinary monetary policy accommodation that is no longer needed. In the Board's January monetary policy statement, we indicated that "with inflation well above 2 percent and a strong labor market," we expected that it would "soon be appropriate to raise the target range for the federal funds rate." I fully supported that assessment, and the data we have seen since then have only highlighted the need to move forward with the process of normalizing our interest rate stance and significantly reducing the size of the Federal Reserve's balance sheet. Elevated inflation is eroding living standards for many individuals and threatening the durability (i.e., long-term viability) of this economic expansion.

One bright spot is that employment continues to grow, and many industries are experiencing one of the best job markets we have seen in several decades. Unemployment, at 3.8 percent, is very low, and the ratio between job openings and the number of people looking for work is at a record high. The economy continues to add jobs at a pace of more than 500,000 a month. And while inflation is currently outpacing wage gains, the tight labor market will sustain wage increases at historic levels for some time.

Turning to banking, most community banks were in sound financial condition prior to the pandemic. Ninety-six percent of community banks were profitable, and nonperforming assets remain at historic lows. Many community banks entered the pandemic with well-performing loan portfolios. In addition to developing more effective risk management practices, community banks had fewer credit concentrations in construction and commercial real estate prior to the start of the pandemic in comparison to the last financial crisis. Over this same period, community banks have also maintained stronger capital and liquidity positions.

The strong economic conditions as well as ongoing government support during the pandemic contributed to the resilience and sound financial condition of community banks. Recent examination results have further demonstrated that the overwhelming majority of state member community banks remain in satisfactory condition.

Although their profit margins are still low, community banks have higher aggregate net interest margins, non-interest income to average assets, and average earning assets to average assets than larger banks. More than 99 percent of the community banks have capital ratios above well-capitalized minimums. In terms of liquidity, community banks' metrics generally remain positive. However, many community bankers note challenges with deploying excess liquidity. With limited investment opportunities, community banks are investing in liquid

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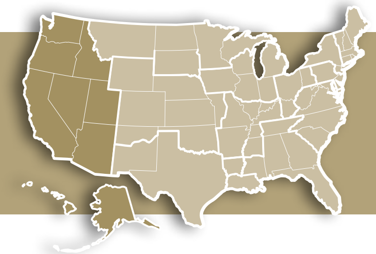
View from the District

A 12th District Perspective — San Francisco



A New Era of Banking: 12th District Community Banks Are Driving Innovation Through Fintech Partnerships

by Lee J. Kapos, Assistant Vice President, Supervision + Credit, Federal Reserve Bank of San Francisco, and Carla Thomas, Examiner, Regional, Community and Foreign Supervision, Supervision + Credit, Federal Reserve Bank of San Francisco

Lee J. Kapos

A new era of banking is upon us. Since the start of the pandemic, innovations in technology combined with a shift in banking habits have motivated community banks[1] to increasingly modernize operational capabilities and offer an expanded array of products and services. Since early 2020, many community banks nationwide have increased their online services by 50 percent or more, and many bankers plan to implement new technology such as digital underwriting or online loan applications and closings within the next year (see Figure).[2] To keep pace with the ever-evolving financial services landscape, several community banks in the 12th District[3] are partnering with nonbank financial technology (fintech) companies to stay competitive and meet the changing needs of their customers.

What's Happening in the 12th District

Partnerships with fintech companies can support community banks by streamlining operational and compliance functions while improving risk management efficiencies. Some banks are working with fintechs to build scalable infrastructures to allow for the development of new customer offerings. Other banks focus on developing tools to better analyze data, enabling them to monitor banking activity while providing products and services tailored to their customers' needs. Regardless of the type of fintech relationship, there's no one-size-fits-all approach to engaging with a fintech firm. It is largely up to a bank's board of directors and senior management to carefully develop its operational plans based on the bank's risk appetite and desired strategic direction.

Cloud Computing

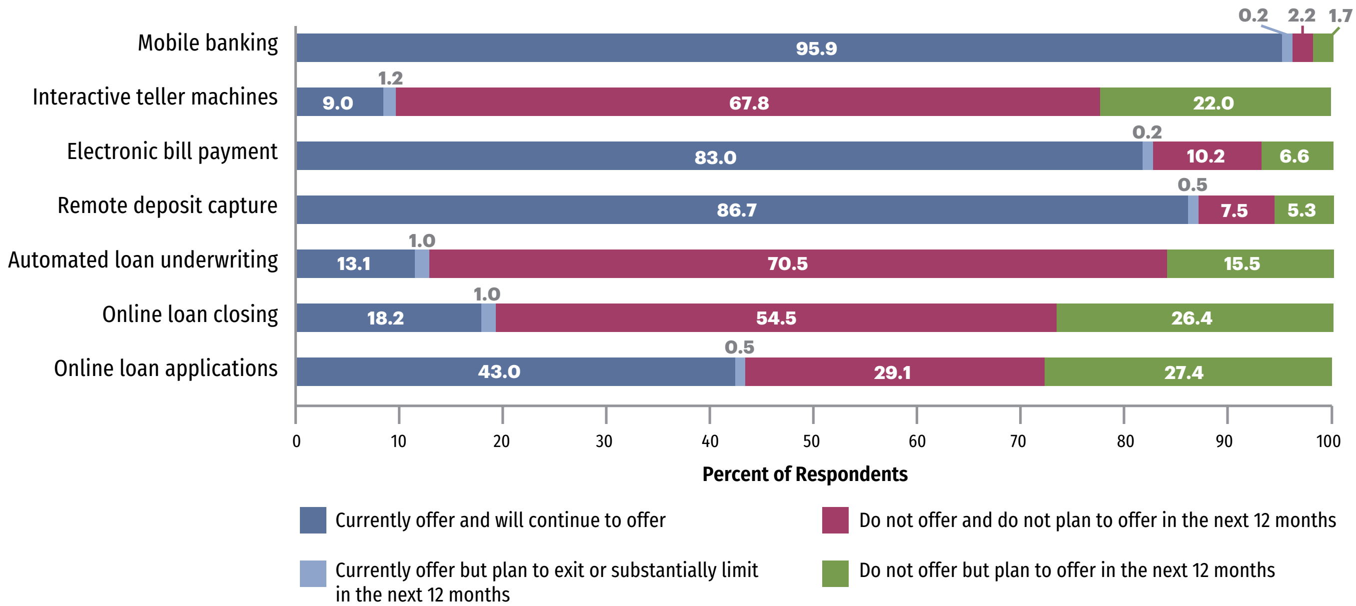
Many 12th District community banks are engaged with cloud service providers (CSPs) to outsource networking, hardware provisioning, and security functions. Unlike other fintech services, cloud technology is not a financial product that banks provide to customers. Cloud services involve storing data in an offsite location hosted by a third party (such as Amazon Web Services or Google Cloud). Banks use cloud services as a vehicle to deliver products and services to their customers. Community banks typically implement a software-as-a-service (SaaS) model, which provides the bank access to various software applications over the cloud while outsourcing the management and controls of the infrastructure and configuration settings. Community banks looking to expand digital banking services may employ CSP partnerships to provide a more flexible, easy-to-scale solution that allows for a relatively seamless roll-out of upgrades and new products. In certain cases, cloud technology promotes operational resilience and improves small banks' abilities to respond quickly to outages resulting from operational failures or nefarious attacks, thus enhancing data security and business continuity

1 *Community banks* are banks with less than $10 billion in total assets.

2 See the results of the Conference of State Bank Supervisors 2021 National Survey of Community Banks, presented at the Community Banking in the 21st Century research and policy conference, available at www.communitybanking.org/~/media/files/publication/cb21publication_2021.pdf.

3 The states in the 12th District are Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah, and Washington.

Figure: Community Banks' Technological Intentions



Source: 2021 Conference of State Bank Supervisors National Survey of Community Banks, Figure 48, page 42, available at www.communitybanking.org/~/media/files/publication/cb21publication_2021.pdf

processes. SaaS models often allow banks to leverage cloud technology across the entire organization, freeing bank resources that can be more effectively focused on core banking activities.

Crypto-Assets

As the number of banks seeking to engage in crypto-asset activities continues to grow, the Federal Reserve Board and other regulatory agencies have indicated plans to provide greater clarity on the permissibility and regulatory expectations surrounding these assets.[4] Considering the specialized expertise and technical knowledge necessary to manage and maintain digital assets, some banks are establishing relationships with fintechs to expand crypto-related offerings to customers. Banks are beginning to partner with fintechs to facilitate the trading, clearing, and settlement of cryptocurrency transactions or affiliate with firms that have well-established frameworks for the custody and management of crypto-assets.

Risk Management

Fintech partnerships also benefit banks by supporting risk management functions such as credit underwriting and vendor management functions such as onboarding support and contract management. Compliance risk management services or regulatory technology, better known as regtech, is similarly gaining traction within community banks. Banks are using regtech for Bank Secrecy Act/anti-money laundering transaction monitoring and customer onboarding and due diligence, as well as other compliance areas such as payment card industry compliance, consumer protection, and regulatory change management.

Banking-as-a-Service

Perhaps the most popular type of fintech partnership trending among community banks in the 12th District (and beyond) is banking-as-a-service (BaaS). In fact, BaaS is predicted to become a $3.6 trillion global industry

[4] *Crypto-asset* generally refers "to any digital asset implemented using cryptographic techniques." See "Joint Statement on Crypto-Asset Policy Sprint Initiative and Next Steps," November 23, 2021, available at www.federalreserve.gov/newsevents/pressreleases/files/bcreg20211123a1.pdf.

by 2030.[5] BaaS allows community banks to link their licensed banking infrastructure with nonbank products and services offered by fintechs, branded as a regulated banking service. In this type of partnership, the fintech firm is the bank's customer and can select a suite of skills and "off the shelf" products or services from the bank in a turnkey fashion. Banks provide back-office functions, such as operational and compliance risk management, while the fintech company is the face of the product or service. BaaS relationships enable fintech firms to offer a variety of products and services such as demand and mobile deposits, prepaid accounts and debit cards, digital wallets, funds transfer services, peer-to-peer payments, and lending to small and midsize businesses.

Supervisory Considerations

In the 12th District, our supervisory team has observed that fintech partnerships can benefit community banks by potentially growing business opportunities, expanding product offerings, and improving efficiencies. However, there are heightened risk exposures, as highlighted in the recent paper "Community Bank Access to Innovation Through Partnerships."[6] Particularly in community banks, the control environment may need strengthening to ensure risk associated with sophisticated fintech partnerships is appropriately managed. The banks with the most success in implementing sound fintech partnerships have established strong risk management frameworks to mitigate strategic, operational, and compliance risks.

Third-Party Risk Management

While various risk management functions and processes can be outsourced, a bank's directors and senior management are ultimately responsible for the quality and effectiveness of the bank's risk management.

This means that robust due diligence,[7] project management, partner onboarding, and business continuity policies and procedures are essential areas to consider when forming fintech relationships.

Information Security and Cybersecurity

Community banks should maintain effective information security programs commensurate with their operational complexities.[8] As a bank shifts toward a digital platform and develops more of a reliance on complex systems and technologies, the risk of error and vulnerability to cyberattacks increases. It is critical for banks to continually assess the risk associated with new and existing products and relationships, especially related to processes for handling and protecting bank customers' sensitive personal information. Information security services provided by third parties, such as password storage, authentication services, and virtual private network services, are growing in popularity and can mitigate risk associated with remote access and digital

[5] See "Banking-as-a-Service. Why It Makes Sense for Banks," *FinExtra* blog, April 8, 2021, available at www.finextra.com/blogposting/20132/banking-as-a-service-why-it-makes-sense-for-banks.

[6] The September 2021 paper is available at www.federalreserve.gov/publications/files/community-bank-access-to-innovation-through-partnerships-202109.pdf.

[7] See "Conducting Due Diligence on Financial Technology Companies — A Guide for Community Banks," August 2021, available at www.federalreserve.gov/publications/files/conducting-due-diligence-on-financial-technology-firms-202108.pdf.

[8] Refer to *FFIEC Information Technology Examination Handbook, Information Security*, September 2016, available at https://ithandbook.ffiec.gov/media/274793/ffiec_itbooklet_informationsecurity.pdf.

banking products. Furthermore, it is important for bank management to provide appropriate oversight of business continuity processes,[9] both internally and within partnerships, to manage any disruption to operations.

"Recognizing that there are fundamental cultural and operational contrasts between most fintechs and community banks, a bank should consider how a fintech firm's business strategy complements its own."

Model Risk Management

Banks often engage fintech firms to leverage the latest technologies in the development of models used for stress testing, financial forecasting, and advanced data analytic services. Innovations used in models such as artificial intelligence and natural language processing will likely expand the scope of banks' model risk management programs. Given the dynamic nature of modeling, banks should ensure models used by fintech partners are periodically tested and validated. As part of effective oversight and management practices, banks should maintain a comprehensive inventory of fintechs' models and understand how partnering fintechs implement their models.

Compliance Risk Management

Of course, examination teams continue to verify whether a bank's new activities (outsourced or conducted in house) comply with applicable laws and regulations and are consistent with safe and sound banking principles.[10] The activities of many fintechs are not covered by statutes and regulations. Nevertheless, banks need to take added vigilance related to consumer protection, data privacy, information security, anti-money laundering, and financial crime when reviewing a fintech partner's compliance function.

Bridging the Risk Management Gap

Innovative technologies often come with new risks. It is important that banks maintain the level of knowledge and expertise required to effectively oversee and control new risk exposures. Management information systems related to the selection of risk indicators are especially central to ensuring that a bank accurately measures and monitors risks. Perhaps most important, bank management should foster a culture of compliance starting with a tone at the top of the organization. This culture of compliance should continue to emphasize the importance of prudent risk management practices throughout the bank and with fintech partners. Recognizing that there are fundamental cultural and operational contrasts between most fintechs and community banks, a bank should consider how a fintech firm's business strategy complements its own.

Final Thoughts

As we move into this new era of banking, risk management remains ever important. If risks are adequately managed and controlled, partnerships between fintechs and community banks can ultimately benefit customers, and the banking system as a whole. ■

9 See *FFIEC Information Technology Examination Handbook, Business Continuity Management*, November 2019, available at https://ithandbook.ffiec.gov/media/296178/ffiec_itbooklet_businesscontinuitymanagement_v3.pdf.

10 Refer to 12 CFR Part 208, Appendix D-1, available at www.ecfr.gov/current/title-12/chapter-II/subchapter-A/part-208/appendix-Appendix%20D-1%20to%20Part%20208.

Success with Succession Planning Q&A

by Romel Bonilla, Supervision Manager, Supervision and Regulation, Federal Reserve Bank of Chicago, Joel D'Souza, Senior Examiner, Supervision and Regulation, Federal Reserve Bank of Chicago, and William Mark, Lead Examiner, Supervision and Regulation, Federal Reserve Bank of Chicago

This article is a follow-up to "Putting the Success in Succession Planning and Management," which appeared in the Second Issue 2021 of *Community Banking Connections*,[1] and the July 27, 2021, Ask the Fed[2] webinar on succession planning. Both the article and the webinar stressed the importance of succession planning, highlighting this endeavor as a key governance and risk management tool. This follow-up article answers several questions submitted by Ask the Fed audience members during the presentation.

On the Horizon

Staff and management turnover are an inevitable occurrence; therefore, a bank should assess its talent resources and plan accordingly. Determining a bank's talent needs is a challenge that requires short- and long-term perspectives. As indicated in Figure 1, the audience's responses to the Ask the Fed's polling questions reinforced the importance of effective succession planning. Sixty-four percent of the participants reported that a change in senior leadership had occurred in the prior two years, that a change is expected in the coming two years, or both.

Supervisory Perspective

When assigning a bank's supervisory rating, do examiners consider the composition of the bank's board of directors, the skill and subject matter expertise of the bank leaders (i.e., information security, business continuity planning, and compliance), or all the above?

In assessing the adequacy of a bank's management, Federal Reserve examiners assess the ability of its board of directors and management to ensure that the bank is operating in a safe and sound manner, considering the size and complexity of the bank's operations. Therefore, bank leadership is expected to exhibit relevant experience, display sustained competence, and demonstrate a high level of integrity.

Discuss how much attention is paid to succession planning during a routine examination. Is it part of the pre-examination risk assessment that may be excluded based on risk, or is it something that examiners review at each examination?

Management capabilities and succession prospects are considered throughout the examination process, influencing pre-examination planning strategies and factoring into the assessment of the bank's viability. Management depth and succession are important considerations for the management rating.[3]

Supervision and Regulation (SR) letter 16-11, "Supervisory Guidance for Assessing Risk Management at Supervised Institutions with Total Consolidated Assets Less Than $100 Billion,"[4] discusses the role and responsibilities of a bank's board of directors and senior management in overseeing risk management. This letter notes that "the board of directors should collectively have a balance of skills, knowledge, and experience to clearly understand the activities and risks to which the institution is exposed, and senior management should ensure that the activities are managed and staffed by personnel with the knowledge, experience, and expertise consistent with

1 The article is available at www.cbcfrs.org/articles/2021/i2/succession-planning-management.

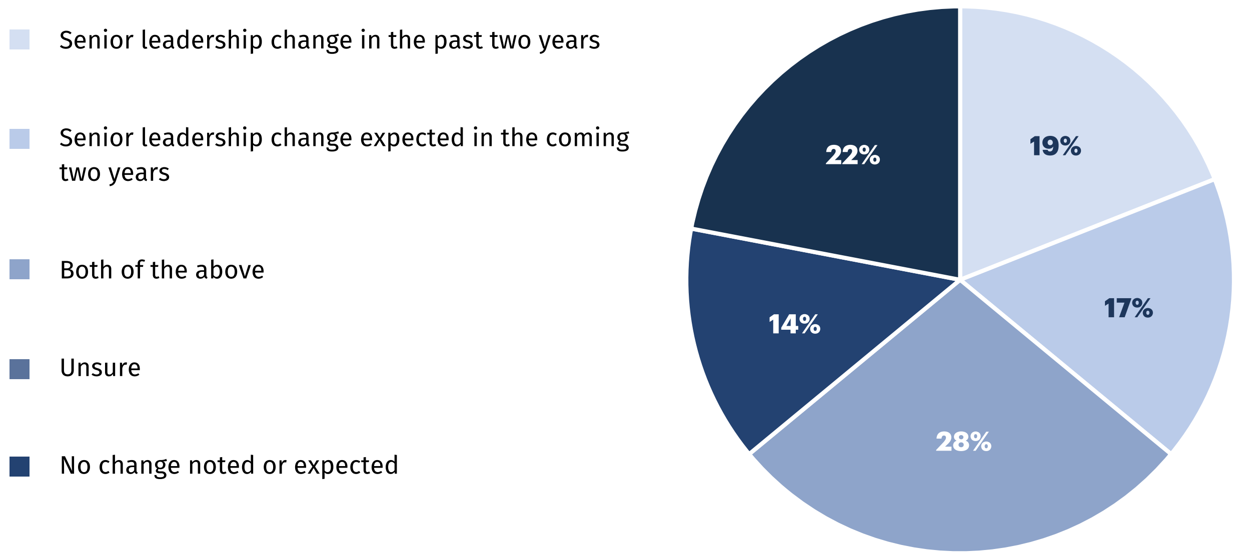
2 The webinar is available on the Ask the Fed website; see https://bsr.stlouisfed.org/askthefed/Home/DisplayCall/310.

3 See SR letter 96-38, "Uniform Financial Institutions Rating System," available at www.federalreserve.gov/boarddocs/srletters/1996/sr9638.htm.

4 See SR letter 16-11, "Supervisory Guidance for Assessing Risk Management at Supervised Institutions with Total Consolidated Assets Less Than $100 Billion," available at www.federalreserve.gov/supervisionreg/srletters/SR1611a1.pdf.

Figure 1: Turnover in Senior Leadership

Have you experienced or do you expect departures in senior leadership (i.e., board and senior management) at your financial institution in the following time horizons?



Source: Ask the Fed: Success in Succession Planning (7/27/21)

the nature and scope of an institution's activities and risks." In assessing the adequacy of risk management, examiners would weigh these factors relative to strategic focus and direction as well as the succession planning process.

For small community banks, would an informal succession plan be sufficient? Or should a formal plan be required regardless of the bank's asset size?

Whether a succession plan is formal (i.e., written) or informal (i.e., not written but discussed among the board and senior management) will depend on the asset size and complexity of the organization. Strategic and logistical variables will vary from bank to bank and will influence a bank's planning process. A less formal succession plan could be appropriate for the needs of a small, noncomplex community bank. However, leadership should be mindful that succession plans address the implementation time frame, which will vary depending on the nature of a management change. Further, a sudden and unexpected departure of a bank's management team member will likely be an "in an emergency, break glass" moment and, therefore, communication and transparency on leadership changes should also be factored into determining the level of formality in succession plans.

How should a bank document its succession plan?

There are no specific regulatory requirements for how a bank should document its succession plan. That said, a bank should consider the level of detail in a plan such that the board of directors and senior management are aware of the action that will need to be taken when there are leadership and staff departures. Such transparency would serve to guide management and staff through the various aspects of the organization's process to identify, develop, assess, and transition leadership candidates. From a governance perspective, evidence that succession planning is addressed by a board of directors would be considered a safe-and-sound practice.

Challenges and Obstacles

A community bank may face various challenges to developing and maintaining an effective succession program. These potential hurdles include availability of qualified candidates, offering competitive salaries, and retaining the bank's cultural characteristics. In addition, a bank's day-to-day business activities may push succession planning, rightly or wrongly, to a lower priority.

Figure 2 illustrates these challenges. Sixty-four percent of the Ask the Fed participants acknowledged that access to qualified candidates can be difficult (i.e., limited access and strong competition). Shifting workforce and demographics in the community the bank serves, strong competition, and budget constraints were cited as hindering the ability to attract and retain qualified individuals.

What is the optimal lead time to prepare (or update) a succession plan? Too early is risky, too late is risky. Is there a Goldilocks time frame?

The timing of leadership changes can be difficult to predict, which presents challenges in establishing a planning time horizon as well as a time frame for identifying and developing future leaders. Management transition ambiguities can also stymie or even immobilize a planning process. Additionally, there can be confidentiality concerns, from legal and morale perspectives. If a successor is even identified, the first and second "runners-up" could choose to leave the bank or become dissatisfied with their career opportunities. Therefore, a plan should consider when to disclose the management succession plan to staff.

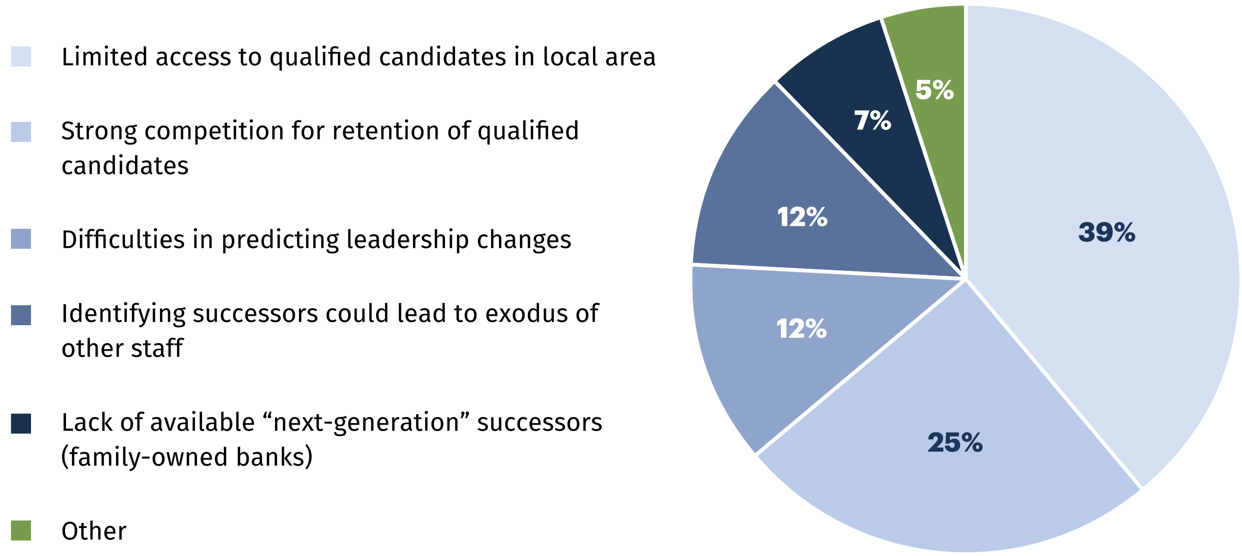
There is also the downside risk of choosing a successor who turns out to not have the skills, knowledge, or even cultural fit to assume a more demanding leadership role. The specter of this possibility could lead to a sort of "paralysis by analysis" that could delay decisions on identifying a successor candidate. Therefore, the board of directors should position management and staff to facilitate smooth transitions to minimize disruptions to bank operations. With this mindset, a bank could include career development planning and discussion as part of its employee performance process.

How often should succession planning take place in a small, family-owned bank?

Small, family-owned community banks face unique challenges in naming a successor, as there may be limited management and staff resources. These banks often restrict senior management to family members and, therefore, may face a lack of interest or a qualified pool from family members who want to or can fill critical management positions. Nevertheless, while succession planning may be difficult, it would be prudent for the bank's board of directors to revisit its succession plan on a periodic basis and consider when current leaders may wish to reduce their day-to-day management responsibilities.

Figure 2: Challenges and Obstacles

What do you see as the greatest challenge/obstacle facing your organization when crafting an effective management succession plan?



Source: Ask the Fed: Success in Succession Planning (7/27/21)

How do you overcome statutory limitations (i.e., statutory requirements for the job posting and interview process) that could impede a bank's ability to plan management succession?

Certain state employment laws cover the timing and procedural requirements for the selection of a successor, which could extend the management selection and transition time frame. These laws are intended to ensure that companies engage in a thoughtful candidate consideration process. Therefore, the timeline for identifying and selecting a candidate to fill key management positions should be considered in the succession planning process to avoid disruption in bank operations. One option is for the plan to designate interim managers for key positions as the selection process is underway.

Responsibilities and Methods

What are some of the key characteristics that examiners see in banks' succession plans?

Examiners have noted that effective succession plans typically consider critical roles, key competencies, transition exposures, and a strategy for developing and evaluating management candidates as highlighted in Figure 3. Conceptually, this can take the form of a bank identifying key positions and potential successors through a cascading tier structure or distribution of key executive position responsibilities among several individuals. When appropriately structured, this planning exercise can contribute to accomplishing both short- and long-term succession goals. However, it is important that senior leadership tailor its succession plan to the unique nature of its organization. A flawed or incomplete succession plan could expose the bank to excessive transition risk when there is a sudden or unexpected departure of a senior leader or key employee.

Figure 3: Succession Planning Process

Identify	Document	Transition	Develop	Assess
Short-/Long-Term Critical Roles	Key Competencies	Transition Successors	Develop Successors	Evaluate Effectiveness
Successors and Skill Sets		Transfer Knowledge		Measure Performance

Source: Romel Bonilla, Joel D'Souza, and William Mark, "Putting the Success in Succession Planning and Management," Second Issue 2021 *Community Banking Connections*, pp. 11–16, available at www.cbcfrs.org/articles/2021/i2/succession-planning-management

Is backup staffing sufficient for senior management succession? To what extent should cross-training of management replacements be expected?

In certain situations, backup staff may be positioned to replace senior management for short-term absences to fulfill day-to-day duties. However, this may not be sufficient for succession planning, as backup staffing alone does not necessarily translate to a long-term strategy. When a backup staff member has been identified as a potential successor, succession planning would create an opportunity for the bank's senior leadership to evaluate the individual's performance and share constructive feedback for future career development.

Cross-training can be used to address planned and unexpected staffing changes. Operational disruptions arising from the loss of any individual are partially mitigated when the bank has sufficient "bench strength" — employees who are prepared to assume management responsibilities, if only on an interim basis. A bank can diversify employee skills through cross-training and other development methods such as having an employee serve on a committee or special project or attend an industry conference. Through cross-training, an individual has opportunities to establish coaching and mentoring relationships. Together these opportunities allow potential successors to develop and expand their knowledge about the bank's operations and management.

Should a bank use a profit-sharing program to retain its top talent?

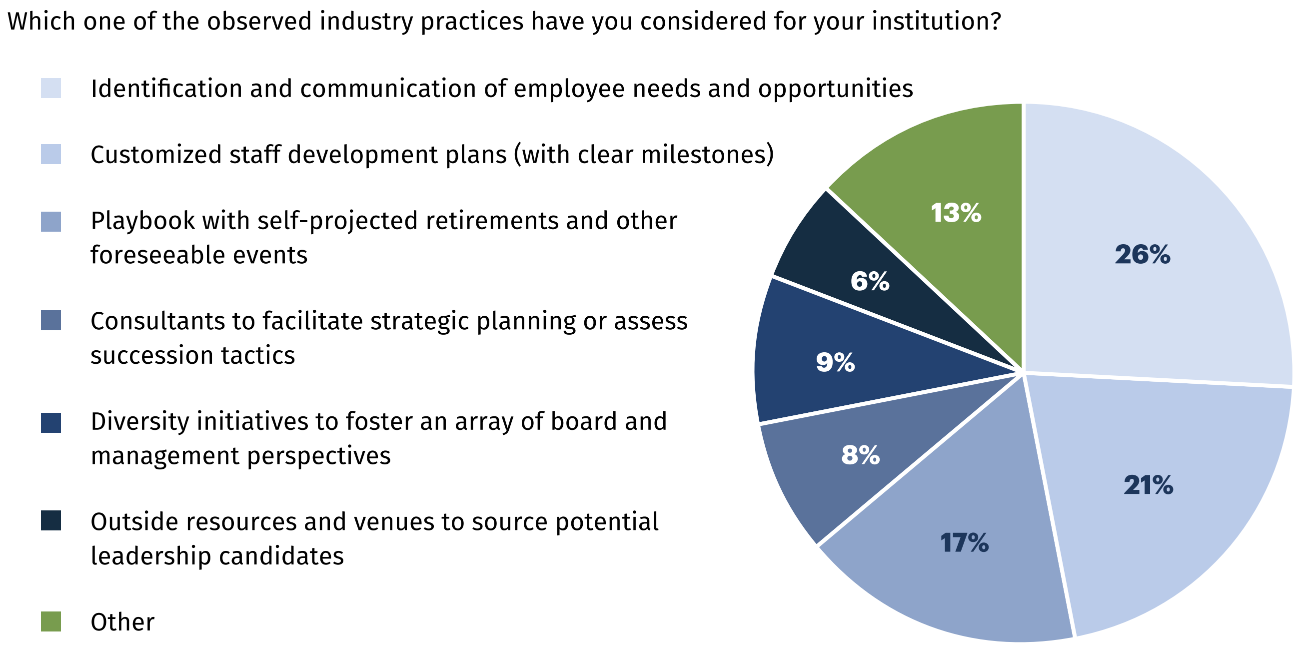
Compensation arrangements are important tools that a bank can use to attract and retain skilled staff. The board of directors should ensure that its incentive compensation arrangements properly align the interests of both the bank and its employees. Because community banks typically face competition for skilled, experienced staff who are interested in the community banking industry, training programs and compensation strategies (i.e., profit-sharing initiatives) can be used to attract and retain individuals capable of fulfilling leadership roles.

The Diversity Paradigm

Were any top-performing, diverse banks in rural, less-diverse areas?

While there have not been studies that specifically targeted smaller banks operating in rural, less-diverse areas, it is widely acknowledged that teams with diverse experiences can slow the progression to groupthink, the

Figure 4: Preferred Industry Practices



Source: Ask the Fed: Success in Succession Planning (7/27/21)

phenomenon in which leaders with similar backgrounds tend to align in thought and gravitate toward the same strategies. Therefore, regardless of a bank's size, complexity, or location, discussion of alternative viewpoints can contribute to a diversity of thought strategy and advance success at the bank.

Observed Industry Practices

The final question posed to the Ask the Fed audience was about industry practices relative to succession management techniques (Figure 4). Forty-seven percent of the respondents noted that they considered a staff-focused approach to succession planning by identifying and developing employees as the most appropriate practice. Further, 17 percent of the respondents indicated that they use a playbook with self-projected retirements and position readiness indicators for senior management and the directorate. Diversity initiatives to foster a wide array of viewpoints from leadership were considered by 9 percent of the respondents, and 8 percent turned to consultants to supplement planning tactics.

Final Thoughts

Succession planning is essentially a risk management tool designed to minimize the adverse effects of transition risk related to leadership change. Given the importance of maintaining qualified bank leadership, any significant disruption in the bank's operations can have far-reaching, negative ramifications for a bank's safety and soundness. Hence, an effective successor management plan is nimble enough to respond to changes in bank leadership in a timely fashion. Therefore, the succession plan should address a bank's management resources and skill sets, while considering economic conditions and strategic business plans to support the viability of the bank.

Understanding Federal Reserve Supervision and Becoming a State Member Bank

by Kerri Allen, Examiner, Examinations & Inspections, Federal Reserve Bank of Kansas City, and Jeff Legette, Assistant Vice President, Examinations & Inspections, Federal Reserve Bank of Kansas City

For nearly 200 years, the dual federal and state banking system has existed as part of constitutional law.[1] State-chartered institutions are primarily supervised by a state regulator and operate under state laws and regulations. Additionally, the Federal Reserve or the Federal Deposit Insurance Corporation (FDIC) supervises state-chartered institutions. The Federal Reserve supervises, among other entities, state-chartered banks that are members of the Federal Reserve System (state member banks). Further, the Federal Reserve has supervisory and regulatory authority for all bank holding companies (BHCs) and savings and loan holding companies. The Office of the Comptroller of the Currency (OCC) supervises national banks, which generally operate under federal laws and regulations.

The decision to apply for a state or federal charter largely dictates a bank's primary federal regulator. The choice between a federal or state banking charter can often be a complex decision for bank management and other stakeholders. In deciding on a state or federal charter, either as a new institution or through a conversion, bank management or other institutional decision-makers consider the key activities and primary goals of the institution, as well as the supervisory approaches of the primary state and federal regulators. This article provides an overview of being a state member bank and receiving oversight from the Federal Reserve.

Risk-Focused, Tailored Supervisory Approach

Since the mid-1990s, the Federal Reserve has applied a risk-focused approach to supervision of community state member banks, emphasizing the assessment of prudent risk management practices and internal controls.

The Federal Reserve executes a consistent approach to risk-focused safety and soundness supervision, in part, by leveraging an automated surveillance tool, referred to as the Bank Exams Tailored to Risk (BETR)[2] model. The BETR model helps examiners objectively identify risks at a bank through aggregated data metrics. Results of this model are combined with examiner judgment and knowledge about a bank to develop an examination scope that aligns with a bank's risk profile. By focusing examiner resources on the areas of highest risk and streamlining examination work programs on lower-risk areas, the Federal Reserve can reduce the supervisory burden on banks. For example, the BETR model aids examiners in assessing the level of a bank's credit risk. For banks that are designated as low or moderate risk, Federal Reserve examiners generally complete 50 to 75 percent of the loan coverage expectations as they would for banks with high credit risk.

Similarly, consumer compliance examiners employ the Community Bank Risk-Focused Consumer Compliance Supervision Program to tailor consumer examinations at banks with less than $10 billion in total consolidated assets. This Federal Reserve program is designed to ensure consumer compliance examinations are appropriately tailored to a bank's compliance risk, with resources focused on those bank activities with the greatest risk. Under this program, compliance examinations for low-risk banks require about half the time and resources as examinations for higher-risk banks.[3]

1 See Carl Felsenfeld and Genci Bilali, "Is There a Dual Banking System," 2008, available at https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1477&context=faculty_scholarship.

2 For Federal Reserve Board (FRB) guidance on bank examination risk tiering and scoping, see Supervision and Regulation (SR) letter 19-9, "Bank Exams Tailored to Risk (BETR)," available at www.federalreserve.gov/supervisionreg/srletters/sr1909.htm.

3 For FRB guidance on consumer compliance risk-focused supervision, see Consumer Affairs letter 13-19, "Community Bank Risk-Focused Consumer Compliance Supervision Program," available at www.federalreserve.gov/supervisionreg/caletters/caltr1319.htm.

In addition to the BETR model and other examination scoping mechanisms, the Federal Reserve's supervisory process incorporates various automated tools and advanced data analytics technologies to support and enhance the quality of ongoing monitoring activities. For example, Reserve Banks create and leverage a variety of surveillance reports and models that provide aggregate data on both a District- and System-wide basis. Through such analytics, supervisory staff can identify and analyze risk for banks with similar risk characteristics. In turn, examiners use this information to discuss relevant risk trends or emerging risks with bankers between scheduled examinations.

Supervisory Coordination and Consolidated Oversight

The Federal Reserve assigns a dedicated safety and soundness and/or consumer compliance examiner as a primary point of contact to each supervised institution. These contacts provide technical assistance and can connect bankers to key Federal Reserve resources, including subject matter experts and outreach activities. The Federal Reserve point of contact allows for efficient, consistent, and responsive communications between a supervised bank and Federal Reserve staff and promotes transparent supervision. From scoping and planning to the exit meeting and ongoing monitoring, the Federal Reserve prioritizes effective communications with bankers across all aspects of the examination process.[4]

The Reserve Banks also work closely with state supervisory counterparts to ensure proper coordination and efficiency of supervisory activities. In addition to coordinating with state counterparts for supervisory purposes, as the sole supervisor of BHCs, Federal Reserve examiners provide a broad view of the entire banking organization as well as the relationship between entities under the consolidated organization. Similar to its approach to state member bank supervision, the Federal Reserve tailors the supervision of holding companies based on the asset size and complexity of the organization.

[4] For FRB guidance on communication expectations for community bank examinations and expectations, see SR letter 19-5, "Communication Expectations for Community Bank Examinations and Inspections," available at www.federalreserve.gov/supervisionreg/srletters/sr1905.htm.

Federal Reserve Supervision Staff

Federal Reserve safety and soundness and consumer compliance management teams have broad knowledge and significant subject matter expertise. Before being commissioned as examiners, individuals undergo a rigorous, multiyear training program, which includes on the job training. The Federal Reserve's training program is centralized to promote consistent supervisory assessments. Post-commissioning, examiners are provided with ongoing training and professional development opportunities to ensure skill sets are maintained regarding new guidance, regulations, and banking trends and risks.

> "The choice between a federal or state banking charter can often be a complex decision for bank management and other stakeholders."

The Reserve Banks hire examiners with a broad spectrum of backgrounds, certifications, education, and experience. Federal Reserve examiners are accustomed to navigating a wide range of banking complexities specific to the markets served by supervised banks. Also, many examiners have industry expertise in key lending areas such as agriculture, commercial real estate, and energy.

The Federal Reserve hires, trains, and develops a variety of "specialty" examiners who possess deep subject matter expertise in the areas of Bank Secrecy Act/anti-money laundering, information technology, and trust. These experts examine a broad range of institutions and use this horizontal perspective to support their discussions with bank management. In the area of consumer compliance, many examiners have specialized knowledge about fair lending, the Community Reinvestment Act, and other consumer-related topics.

Outreach Resources and Other Federal Reserve Services

The Federal Reserve, at both the System and local levels, creates and contributes to many publications, resources, and other materials that can provide useful information and analyses to banks and the public. Many of the outreach materials produced by the Federal Reserve highlight local, regional, and national economic and industry trends, as well as current events that could potentially affect the banking industry. In addition, various outreach mechanisms are in place to ensure that regulatory updates, including new or revised supervisory guidance, are disseminated and explained to the appropriate audience.

One such mechanism is the Supervisory Contact System, which allows local Reserve Banks to provide state member banks with timely communications on regulatory updates and other relevant supervisory information. Such resources allow bank management to remain informed about changes in banking laws and regulations that may have implications on the bank's operations. The local Reserve Banks also regularly hold open conferences and seminars on salient topics such as bank supervision, economic research and trends, and emerging issues and trends in the banking industry. On the national level, the Federal Reserve sponsors outreach events and forums for collecting or sharing data on market and economic conditions and for communicating supervisory updates and emerging issues.

The Federal Reserve offers multiple training opportunities and informational sessions for state member banks and the public, including Ask the Fed sessions and other resources. The Ask the Fed outreach forum allows subject matter experts from the Federal Reserve to deliver information on regulatory updates, supervisory guidance and priorities, and economic conditions to bankers and other stakeholders.[5] In 2021, the average attendance for an Ask the Fed session was 3,200 individuals, demonstrating that this is a popular resource for bankers.

In addition to cultivating highly trained examiners who are familiar with local economic and banking conditions, the Federal Reserve employs experts in other areas and functions that can assist supervised institutions. For example, bankers can speak directly with Reserve Bank applications experts who have experience in evaluating expansionary proposals, such as branch openings and mergers and acquisitions. The Reserve Bank staff can guide state member banks and holding companies through the filing process. Additionally, bankers may have opportunities to engage with subject matter experts in emerging payments technologies, fintech firms, and the discount window and master account administration, as well as cash services or other financial services areas. State member banks may also contact their local Reserve Bank for any questions relating to regulatory reporting preparation.

Federal Reserve Structure

The Federal Reserve Board is responsible for setting the regulatory framework that applies to state member banks. However, the execution of supervisory activities generally is delegated to the local Reserve Banks. Reserve Bank board members bring a deep understanding of the challenges faced by the banking industry and knowledge about local and regional economic and market conditions. The Federal Reserve's decentralized structure also includes Reserve Bank branches. A regional branch structure ensures sufficient supervisory coverage of state member banks across the entirety of the United States, including more remote areas. Some Reserve Banks have multiple branches (up to five, in the case of Atlanta), with local management and staff who are highly knowledgeable of their respective region's unique economic characteristics. As Governor Michelle W. Bowman stated, "This structure gives our examiners deep insights into thousands of local economies across the U.S. and helps us understand the local industries that are vital to the long-term health and success of these communities."[6]

[5] Ask the Fed is available at https://bsr.stlouisfed.org/askthefed/Auth/Logon.

[6] See Governor Bowman's September 28, 2021, speech, "Creating a New Model for the Future of Supervision," available at www.federalreserve.gov/newsevents/speech/bowman20210928a.htm.

State member banks provide invaluable input to regional discussions on economic and banking conditions, helping Reserve Bank presidents formulate their overall views of regional conditions. By participating in discussions and data-gathering exercises such as periodic surveys, state member banks help inform the Federal Reserve Board about key risks, trends, and insights happening at the local and regional levels that can ultimately influence policy. One such example is the national Community Depository Advisory Council (CDIAC). The CDIAC comprises representatives from banks, thrift institutions, and credit unions who serve as local advisory council members at the 12 Reserve Banks and provide input to the Board on the economy, lending conditions, and other areas of interest to community depository institutions.[7]

How to Become a State Member Bank

If your organization is considering a state bank charter or membership in the Federal Reserve System, you may contact individuals within the supervisory or applications functions of your local Reserve Bank to discuss the application process. Information on membership requirements can also be found in the Federal Reserve Board's Regulation H, Membership of State Banking Institutions in the Federal Reserve System (12 CFR part 208).[8] Further, you may access information on membership applications through your local Reserve Bank's website or visit the Applications section of the Board of Governors of the Federal Reserve System's public website.[9]

Concluding Thoughts

In determining if membership in the Federal Reserve System as a state-chartered bank is right for your organization, there are multiple factors and options to consider. State member banks are subject to tailored, risk-focused examinations and ongoing monitoring led by qualified and experienced Reserve Bank examination staff. Additionally, your organization will have access to outreach events and materials and Federal Reserve subject matter experts in multiple areas of focus. ■

[7] For an overview of the CDIAC, visit www.federalreserve.gov/aboutthefed/cdiac.htm.

[8] See 12 CFR 208.3, "Application and Conditions for Membership in the Federal Reserve System," available at www.govinfo.gov/app/details/CFR-2021-title12-vol2/CFR-2021-title12-vol2-sec208-3.

[9] See the web page at www.federalreserve.gov/supervisionreg/application-process.htm.

2022 Writers' Cohort

Meet a Cohort Member

Last year, *Community Banking Connections* put out a call for writers, and six candidates were selected to join the Writers' Cohort. The next several issues of the publication will feature profiles of the new writers. In this issue, Ray Bolton discusses how a professor directed him to the USA Jobs website to find his career, explains how his passion for the trombone has him playing in three different community bands around Chicagoland, and reveals his ultimate guilty pleasure.

Ray Bolton

Senior Assistant CRSB Examiner, Supervision and Regulation, Regional and Community Supervision, FRB Chicago

How long have you been with the Fed? What brought you here?

I've been with the Fed for a little over three years now. I started back in July 2018, just a few months after finishing my undergraduate degree in economics at Illinois Wesleyan University (IWU). I had a professor at the time who was happy to help me search for job opportunities as I got closer to graduating, and he suggested I take a look at the USA Jobs website to see what was out there. Being an econ major, I was pretty familiar with the Fed and what it does, and I knew it'd be a very cool opportunity if I could work there. In fact, the Economics Society at IWU had an annual tradition of taking a trip to Chicago with one of the main stops being the Fed's Money Museum. At the time, I just so happened to be the club president and had helped plan that trip, so the Fed was at the forefront of my mind. I found two postings from the Chicago Fed, one in economic research and one for a bank examiner position, and applied to both. I thought I had a better chance of hearing back about the research position because I had submitted my senior research project at IWU as my writing sample, but I heard back about the examiner position. After interviewing, I knew the job was something I would love doing. Three years in and that sentiment still holds true.

If you weren't working at the Fed, what would be your next career choice?

This is a big jump, but if I wasn't working at the Fed my next career choice would be as a professional musician. I've been playing trombone since I was about 11 or 12 years old and absolutely love it. I struggled a lot when I was a junior and senior in high school deciding whether to pursue bass trombone performance or economics. I eventually decided on economics (clearly), but it was a tough choice. I did continue to play in multiple ensembles in college from jazz band to pep band to orchestra, and today I play in three different community bands around Chicagoland. I think I made the right choice, but I still wonder every now and again how things would have turned out if I had chosen music as my career.

Here, from left to right, musicians Chris Boddy, Justin Poole, and Ray are getting ready to play in the band's South of the Border Concert, which took place on February 27, 2022. The concert featured pieces by Latin American composers and was inspired by Latin American musical styles.

What hobbies are you most passionate about?

This is definitely the nerdiest thing about me, but my main hobby outside of music is tabletop games, specifically the Middle-earth Strategy Battle Game from Games Workshop. I'm a huge fan of *The Lord of the Rings* and all things Tolkien, so when I found a tabletop game themed around Middle-earth, I instantly fell in love, or perhaps *obsession* would be a bit more accurate. The game is a blast to play, but that's just one of the aspects of the hobby. It's played using themed models of characters from Middle-earth that are supplied unpainted and unassembled. Building and painting each character is a labor of love and can fill quite a few pleasant afternoons. Plus, seeing your hand-painted models on the tabletop gives a fantastic sense of accomplishment and provides a new level of realism to the game!

If you could visit any place in the world for a month, where would you go and why?

I haven't done a lot of international travel, so I should probably pick someplace new, but if I'm being honest, I'd love to go back to Austria. I went to Vienna a few years ago and absolutely fell in love with the place. The city had such an incredible aesthetic to it, from the cobblestone streets to the corner cafés. There is so much history to explore, especially music history, that I feel I could go for a year and still have more to discover. The natural beauty of Austria is also astounding, and I would love to see the Austrian Alps. My highest priority if I went back, though, would be to see a performance at the Vienna Opera House. I'm a huge fan of opera, and while I was able to see the opera house from the outside when I was there, all of the performances were sold out months in advance of my trip.

What is your guilty pleasure?

My guilty pleasure is romantic movies and TV shows, hands down! There's nothing better than watching the intense ups and downs of an exaggerated relationship on the screen. Some of my favorites are *Just Friends* (perfect for the holidays), *The Last Five Years*, and, of course, *Bridgerton*. *Love Story* on HBO Max is my most recent binge show, and a second season was just released, so I have plenty to watch. ■

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A Message from Governor Bowman
Continued from page 2

securities or holding higher levels of cash and balances due from depository institutions (including balances due from the Federal Reserve).

Community banks are generally demonstrating sound asset quality based on traditional metrics. Total problem loan rates continued to decrease for these institutions, as well as for most larger firms. The problem loan rates for commercial real estate, residential real estate, and other loans were lower or relatively flat. Overall, community banks are reporting favorable credit conditions, with no significant credit issues, low delinquency levels, and manageable credit quality concerns. However, they still report increased loan competition and, as a result, are offering loan terms with extended amortizations and longer-term fixed rates.

While there are still risks and lingering uncertainty in the economy, I remain confident that community banks will continue to play a vital role in advancing the current economic expansion. Over the next few months, I look forward to further discussions with community bankers about their business challenges and views on our supervisory and regulatory framework. These discussions provide valuable information as I assess the implications of any regulatory and supervisory policy changes on community banks. ■

D.C. UPDATES

D.C. Updates features highlights of regulatory and policy actions taken by the Federal Reserve since the last issue as well as a listing of speeches and congressional testimonies of the Federal Reserve Board members that may be of interest to community bankers. For all of the Federal Reserve Board's rulemakings, press releases, testimonies, speeches, and policy statements, visit the Federal Reserve's website at www.federalreserve.gov/.

ACTIONS

Actions Related to Safety and Soundness Policy

On January 25, 2022, the Federal Financial Institutions Examination Council (FFIEC) issued a statement of principles on examination information requests. Supervision and Regulation (SR) letter 22-3/Community Affairs (CA) letter 22-1 is available at www.federalreserve.gov/supervisionreg/srletters/SR2203.htm.

On December 21, 2021, the federal banking agencies released the Interagency Statement on the Community Bank Leverage Ratio Framework. SR letter 21-21 is available at www.federalreserve.gov/supervisionreg/srletters/SR2121.htm.

On December 1, 2021, the FFIEC released new and updated sections of the *Bank Secrecy Act/Anti-Money Laundering Examination Manual.* SR letter 21-18 is available at www.federalreserve.gov/supervisionreg/srletters/SR2118.htm.

On November 24, 2021, the Federal Reserve released its semiannual *Supervision and Regulation Report* to provide an overview of its supervisory and regulatory policies and actions and a financial overview of current banking conditions. The report is available at www.federalreserve.gov/publications/2021-november-supervision-and-regulation-report.htm.

The federal banking agencies approved a final rule requiring computer-security incident notification. The final rule requires a banking organization to notify its primary federal regulator of any significant computer-security incident as soon as possible and no later than 36 hours after the banking organization determines that a cyber incident has occurred. The November 18, 2021, press release is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20211118a.htm.

On October 20, 2021, agencies issued an Interagency Statement on Managing the LIBOR Transition. The statement was from the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the National Credit Union Administration, and the Consumer Financial Protection Bureau (CFPB). SR letter 21-17/CA letter 21-15 is available at www.federalreserve.gov/supervisionreg/srletters/sr2117.htm.

Actions Related to Consumer Policy

On December 17, 2021, the Federal Reserve issued Revised Home Mortgage Disclosure Act Examination Procedures. CA letter 21-17 is available at www.federalreserve.gov/supervisionreg/caletters/caltr2117.htm.

Agencies released annual asset-size thresholds under Community Reinvestment Act (CRA) regulations. The Federal Reserve Board and the FDIC announced the 2022 updated asset-size thresholds used to define "small bank" and "intermediate small bank" under their CRA regulations. The December 16, 2021, press release is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20211216a.htm.

Agencies announced dollar thresholds in Regulations Z and M for exempt consumer credit and lease transactions. The Federal Reserve Board and the CFPB announced the dollar thresholds used to determine whether certain consumer credit and lease transactions in 2022 are exempt from Regulation Z (Truth in Lending) and Regulation M (Consumer Leasing). The December 1, 2021, press release is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20211201b.htm.

Agencies announced the threshold for smaller loan exemption from appraisal requirements for higher-priced mortgage loans. The CFPB, the Federal Reserve Board, and the OCC announced that the 2022 threshold for exempting loans from special appraisal requirements for higher-priced mortgage loans will increase from $27,200 to $28,500. The December 1, 2021, press release is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20211201a.htm.

Other Board Actions and Releases

The Federal Reserve Board released a discussion paper that examines the pros and cons of a potential U.S. central bank digital currency (CBDC) on January 20, 2022. The discussion paper invites public comment and is the first step in a discussion of whether and how a CBDC could improve the safe and effective domestic payments system. The paper does not favor any policy outcome and is available at www.federalreserve.gov/newsevents/pressreleases/other20220120a.htm.

The Federal Reserve Board finalized a technical rule that will streamline reporting requirements for member banks related to their subscriptions to Federal Reserve Bank capital stock. The final rule amends Regulation I to reduce the quarterly reporting burden for member banks by automating the application process for adjusting their subscriptions to Federal Reserve Bank capital stock, except in the context of mergers. The January 10, 2022, press release is available at www.federalreserve.gov/newsevents/pressreleases/bcreg20220110a.htm.

SPEECHES

Speeches Related to the U.S. Economy and Monetary Policy

Governor Christopher J. Waller gave a speech at the Forecasters Club of New York, New York, on December 17, 2021. His speech, titled "A Hopeless and Imperative Endeavor: Lessons from the Pandemic for Economic Forecasters," is available at www.federalreserve.gov/newsevents/speech/waller20211217a.htm.

Governor Michelle W. Bowman gave a speech at the Virtual Symposium on Indigenous Economies: Bank of Canada, Tulo Centre of Indigenous Economics, the Reserve Bank of New Zealand, on November 29, 2021. Her speech, titled "Engagement, Research, and Policy: Integrating Indigenous Voices into Economics Inclusion at the Federal Reserve," is available at www.federalreserve.gov/newsevents/speech/bowman20211129a.htm.

Chair Jerome H. Powell gave opening remarks at the Conference on Diversity and Inclusion in Economics, Finance, and Central Banking, sponsored by the Bank of Canada, the Bank of England, the Board of Governors of the Federal Reserve System, and the European Central Bank, (via webcast) on November 9, 2021. His remarks are available at www.federalreserve.gov/newsevents/speech/powell20211109a.htm.

Governor Michelle W. Bowman gave a speech at the Women in Housing and Finance Public Policy Luncheon, Washington, D.C., on November 8, 2021. Her speech, titled "The U.S. Housing and Mortgage Market: Risks and Resilience," is available at www.federalreserve.gov/newsevents/speech/bowman20211108a.htm.

Chair Jerome H. Powell gave opening remarks at the Gender and the Economy Conference, a symposium hosted by the Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, Washington, D.C., (via webcast) on November 8, 2021. His remarks are available at www.federalreserve.gov/newsevents/speech/powell20211108a.htm.

Former Governor Randal K. Quarles gave a speech at the 2021 Milken Institute Global Conference "Charting a New Course," Beverly Hills, CA, on October 20, 2021. His speech, titled "How Long Is Too Long? How High Is Too High?: Managing Recent Inflation Developments Within the FOMC's Monetary Policy Framework," is available at www.federalreserve.gov/newsevents/speech/quarles20211020a.htm.

Former Governor Randal K. Quarles gave a speech at the Third Conference on Financial Stability, Madrid, Spain, on October 18, 2021. His speech, titled "Financial Stability and Coordination in Times of Crisis," is available at www.federalreserve.gov/newsevents/speech/quarles20211018a.htm.

Speeches Related to Supervision and Regulation

Governor Michelle W. Bowman gave a speech at the 2021 Community Bankers Symposium: Banking on the Future, Federal Reserve Bank of Chicago, on October 22, 2021. Her speech, titled "The Lack of New Bank Formations Is a Significant Issue for the Banking Industry," is available at www.federalreserve.gov/newsevents/speech/bowman20211022a.htm.

Speeches Related to Innovation and Payment Systems

Governor Christopher J. Waller gave a speech at "Planning for Surprises, Learning from Crises" 2021 Financial Stability Conference, cohosted by the Federal Reserve Bank of Cleveland and the Office of Financial Research, (via webcast) on November 17, 2021. His speech, titled "Reflections on Stablecoins and Payment Innovations," is available at www.federalreserve.gov/newsevents/speech/waller20211117a.htm.

Other Speeches

Former Governor Randal K. Quarles gave a speech at the American Enterprise Institute, Washington, D.C., on December 2, 2021. His speech, titled "Between the Hither and the Farther Shore: Thoughts on Unfinished Business," is available at www.federalreserve.gov/newsevents/speech/quarles20211202a.htm.

Former Vice Chair Richard H. Clarida gave a speech at the Federal Reserve Bank of Cleveland, (via livestream) on November 30, 2021. His speech, titled "Federal Reserve Independence: Foundations and Responsibilities," is available at www.federalreserve.gov/newsevents/speech/clarida20211130a.htm.

Chair Jerome H. Powell gave introductory remarks at the opening of the New York Innovation Center, Federal Reserve Bank of New York, (via webcast) on November 29, 2021. His remarks are available at www.federalreserve.gov/newsevents/speech/powell20211129a.htm.

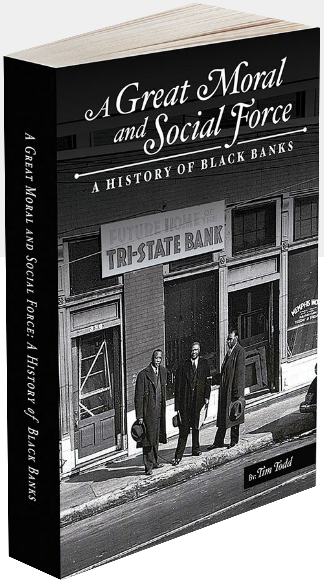
Governor Michelle W. Bowman gave welcoming remarks at the Women in Banking Symposium, Federal Reserve Bank of Richmond, (via webcast) on October 19, 2021. Her remarks are available at www.federalreserve.gov/newsevents/speech/bowman20211019a.htm.

TESTIMONIES

Governor Lael Brainard testified at her nomination hearing before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C., on January 13, 2022. The testimony is available at www.federalreserve.gov/newsevents/testimony/brainard20220113a.htm.

Chair Jerome H. Powell testified at his nomination hearing before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C., on January 11, 2022. The testimony is available at www.federalreserve.gov/newsevents/testimony/powell20220111a.htm.

Chair Jerome H. Powell testified on the Coronavirus and CARES Act before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C., on November 30, 2021. Chair Powell submitted identical remarks to the Committee on Financial Services, U.S. House of Representatives, Washington, D.C., on December 1, 2021. The testimony is available at www.federalreserve.gov/newsevents/testimony/powell20211130a.htm.



New Book from Kansas City Fed Focuses on History of Black Banks

The Federal Reserve Bank of Kansas City published a new book, *A Great Moral and Social Force: A History of Black Banks*. The book, by the Kansas City Fed's Tim Todd, explores the growth of Black banks in the South and the Midwest during the late 19th and 20th centuries in Richmond, VA; Boley, OK; Chicago; Memphis; and Detroit — cities that each have a rich history of Black wealth and economic success that may not be familiar to many Americans.

The book also explores the challenges these communities and the institutions faced. Rather than presenting a comprehensive history of Black banking, the book examines how community Black banks played a dual role, supporting both economic opportunity and social equality.

"The motivation to create many Black banks, regardless of the time period, was rarely a purely financial endeavor or business opportunity," Kansas City Fed President and CEO Esther George says in the book's foreword. "Instead, many were created with a primary mission of public service. This focus on the community is similar to the motivation behind many of our nation's small and mid-sized banks today."

In 2019, the Kansas City Fed published Todd's *Let Us Put Our Money Together,* which explores the efforts to establish the first African American banks in the United States. These books are a part of the Kansas City Fed's Centennial Series, short books that explore a number of important themes in Federal Reserve history, banking, and economic policy.

Books Are Free to the Public

Tim Todd's books are available through the Kansas City Fed's website. To order a free hard copy to be shipped at no charge or to download the PDF version, visit:

- **www.kansascityfed.org/agreatmoralandsocialforce** for ***A Great Moral and Social Force: A History of Black Banks***
- **www.kansascityfed.org/about-us/let-us-put-our-money-together-founding-americas-first-black-banks/** for ***Let Us Put Our Money Together***


FEDERAL RESERVE SYSTEM

COMMUNITY BANKING CONNECTIONS®

A SUPERVISION AND REGULATION PUBLICATION

A Message from Governor Bowman

by Governor Michelle W. Bowman

First Issue 2022

Governor Michelle W. Bowman

Since this is the first *Community Banking Connections* issue of 2022, I wanted to share with you a few thoughts on the state of the overall economy and the community banking sector. As I write this letter in February, I am pleased to note that community banks entered the pandemic in sound condition, played an important role in channeling emergency lending to keep local businesses open, and have remained well capitalized and able to maintain lending to their customers during the recovery. That recovery has continued despite the recent Omicron-related surge in infections. While there are still risks and lingering uncertainty, indications are that we will have another year of strong economic growth. Even with strong growth, I expect some bumps along the path to normal economic activity and public policy. These bumps include the ongoing and likely longer-term effects of bottlenecks on supply chains, which could limit economic activity and push prices higher.

Inflation is a significant problem for families and businesses. As of February, reports showed the highest U.S. inflation readings in 40 years. These reports reflect, in part, supply chain disruptions associated with the economic effects of the pandemic. Unfortunately, supply-side issues cannot be effectively addressed by monetary policy. But strong demand and a very tight labor market have also contributed to inflation pressures, and the Federal Reserve can help alleviate those pressures by removing extraordinary monetary policy accommodation that is no longer needed. In the Board's January monetary policy statement, we indicated that "with inflation well above 2 percent and a strong labor market," we expected that it would "soon be appropriate to raise the target range for the federal funds rate." I fully supported that assessment, and the data we have seen since then have only highlighted the need to move forward with the process of normalizing our interest rate stance and significantly reducing the size of the Federal Reserve's balance sheet. Elevated inflation is eroding living standards for many individuals and threatening the durability (i.e., long-term viability) of this economic expansion.

One bright spot is that employment continues to grow, and many industries are experiencing one of the best job markets we have seen in several decades. Unemployment, at 3.8 percent is very low, and the ratio between job openings and the number of people looking

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With each issue of *Community Banking Connections*, we aim to highlight the supervisory and regulatory matters that affect you and your banking institution the most, providing examples from the field, explanations of supervisory policies and guidance, and more. We encourage you to contact us with any ideas for articles so that we can continue to provide you with topical and valuable information.

Direct any comments and suggestions to editor@communitybankingconnections.org.

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