# The Future of Banking

**By Greg Gonzales,** Commissioner, Tennessee Department of Financial Institutions

I have some thoughts on our future. Fundamentally, I am very optimistic about the future of community banking in Tennessee. There are two basic reasons for my optimism.

First is the resiliency that Tennessee bankers have shown over the last few years and what they have accomplished in helping the state weather the great recession.

But another reason is that the Haslam administration understands we must have a healthy community bank system in Tennessee to meet the governor's goals for the state. Governor Haslam has been very supportive of our department and has put us in a good position to be successful.

I am not naïve though. There are challenges, as we all know. One of my primary concerns is that the regulatory environment is not doing enough to create the opportunity for community banks to contribute to economic progress.

It appears, at times, that Washington creates the regulatory landscape and then tells bankers to do their best to conform to what Washington created.

Instead, if we really believe that the community bank business model is good for the country, as many profess, then regulators need to do a better job of being more accommodative to that model. Regulators can do more to mold regulation to the community bank business model. That is how we create a better future, and it starts with mission and philosophy.

So what are the signs for the future? Are we making any progress?

The very first thing you want to see is a dialogue about the future, and I am pleased to report that I am seeing an increase in discussions, research, and data regarding community banks.


**Commissioner Gonzales speaks at the 2013 TBA *Credit Conference*.**

## CSBS–Federal Reserve Research Conference

Something particularly of note is the CSBS–Federal Reserve "Community Banking in the 21st Century" research conference. This fall, we held the second annual community banking research conference, so generously hosted by the Federal Reserve Bank of St Louis. I really commend the Federal Reserve System for being a part of this, because they are helping to create a conversation that is very unique and which we hope will produce future fruit.

The conference drew together academics, community bankers, and federal and state policymakers from across the country to discuss the latest research and trends in the community banking space.

The research and discussions centered around three main focal points:

- new banks and emerging technologies,
- the effect of government policy on bank lending and risk taking, and
- the effect of government policy on community bank viability.

All the research papers presented were insightful. For example, one paper discussed the use of guidance as a macro-prudential tool which can have very meaningful impact on bank behavior but may also cause unintended consequences. The 2006 Commercial Real Estate (CRE) guidance is a good example of this. The guidance curbed CRE concentrations ahead of the crisis, but it also caused a reduction in commercial and industrial (C&I) lending. The reduced concentration in CRE lending may have dampened the impact of the financial crisis, but reduction in C&I lending also may have hastened the economic recession.

DC is a data-driven town. So,

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**Commissioner Gonzales and Steven L. Antonakes at the TBA 2012 *Annual Meeting*. Steven L. Antonakes currently serves as the deputy director and the associate director for supervision, enforcement, and fair lending at the Consumer Financial Protection Bureau (CFPB)**

while your anecdotes are important and continue to be coveted, it is this research and data—combined with the on-the-ground reports you provide to members of Congress and regulators—that ultimately will move the needle in Washington, DC.

## Town Hall Meeting

In addition to the CSBS–Fed conference, we held a town hall meeting during the TBA *Washington Conference* in DC last May, and let me provide just a brief overview of banker comments. Tennessee bankers are clearly concerned about one–size–fits–all regulation. The compliance area was a top example, and the concern extended to the cost of regulation. Some bankers noted a 500 percent increase in compliance costs over the last five years.

With respect to the mortgage rules, bankers were concerned about the complexity of the rules which they believe affects the ability of experienced bank staff to deal with the rules effectively and makes it almost insurmountable for new staff to be acclimated appropriately to the rules. The consensus was that consumers can expect a longer loan process. Bankers concluded that the federal government should attempt fundamentally to "do no harm" and must be careful about unintended consequences.

## Regulatory Right-Sizing

A positive development has been that policymakers and pundits in DC are saying all the right things about community banks. Now, I know there needs to be more actions than words, but I do see this as a positive trend.

I am particularly pleased in Federal Reserve Governor Daniel Tarullo's remarks about varying prudential regulation for banks. As Governor Tarullo said earlier this year, "The aims of prudential regulation for traditional banking organizations should vary according to the size, scope, and range of activities of the organizations."

This is what I call "regulatory right-sizing," and let me briefly tell you what we are doing in this regard to further regulatory balance.

In recent years, we have consistently put the regulatory balance mission in front of our examiners and asked them to ensure safety and soundness but also be mindful of economic development. We also have asked examiners to give us examples of how they have found this balance.

In October, I met with leadership in the department's banking, legal, and HR areas to continue pushing this effort forward. As a result, a reference guide for examiners is being drafted to ensure all examiners understand what we are trying to achieve and what regulatory balance looks like. The guide also will instruct as to what regulatory balance is *not* and what questions should be considered in getting there. A key to our effort is to document examples and to integrate a process into the culture of our department. I hope to talk about this publicly early this year.

Governor Tarullo's comments are encouraging words, and federal regulators have gone beyond just positive speeches.

These efforts include:

- Shifting the Federal Deposit Insurance assessment base to larger institutions to better reflect the risks posed by their nondeposit funding practices.
- Preserving Tier 1 capital treatment for trust-preferred securities held by small bank holding companies through the Collins Amendment.
- Limiting the Consumer Financial Protection Bureau's examination authority to banks with more than $10 billion in assets.
- Excluding small banks from Basel III provisions designed for global institutions, such as the new global liquidity rules or more stringent leverage ratio requirements.

Through efforts like these, Congress and federal regulators have recognized the risks and operations of community banks are different. But it is not enough.

Regulators must also allow examiners to exercise judgment and be flexible when supervising financial institutions, especially community banks. A one-size-fits-all approach does not work for bankers looking to serve the unique needs of their clients and their communities, and it does not work for regulators trying to ensure a safe and diverse banking system.

In addition, policymakers could support the community bank business model better by taking the following actions:

- Design regulations and examination practices that properly account for community banks' relationship lending model, which small businesses and consumers rely heavily upon.
- Grant QM status to all community bank loans held in portfolio.
- Provide community banks with regulatory clarity and transparency regarding fair lending requirements.
- Speed up the application process for community banks by evaluating merger, acquisition, and new activities applications based on their business model and not how application decisions might establish a precedent for large banks to exploit.

*It is not about "turf" or picking some banks over other banks. We don't need an "either/or" banking system in this country. We need big banks AND community banks. We need federal regulators AND state regulators. We need national solutions AND local solutions.*

## Consolidation

We cannot talk about the future without considering consolidation and this subject continues to come up around the state.

Consolidation is alarming when it is a result of community banks' not feeling they have any choice, but positive when community banks come together intentionally to create synergies and more viable banks.

I think consolidation can be an important part of our future if it is not a forced option due to a tough regulatory environment.

For many banks, consolidation does not have to be the answer. We see banks, especially in rural areas, still performing quite well and providing critical financial services to customers that might not receive services but for the community bank.

But if two or more community banks decide to merge to create a stronger opportunity to serve customers, then we will do all we can to support their decision.

I make this point because Washington's conventional wisdom seems to see all consolidation as a good thing. Or, at the very least, it is not considered a bad thing or a result of anything that Washington does.

## Two Systems

I still conclude that the future of Tennessee banking is bright, but we continue to face current and future challenges to ensuring the health and stability of the banking system we need. There are still struggles to overcome, like understanding the impact of regulation on consolidation, one-size-fits-all supervision, and the need to tailor regulation.

Some things have been achieved. I am encouraged by the increase in public symposiums to discuss the community banking system and in increased data and research on the impact of community banks. But more is needed.

Our state/federal system of supervision is one marked with occasional tension and conflicts. This is by design, as we all come from different perspectives based upon our mission, charter, history, and priorities.

It is a mix of state and federal views that gets us to a balanced view. Where there is not that mix, there is not balance. An example of that is the compliance regulatory environment, and we are trying to have a positive impact on that in Tennessee.

I agree we need global financial institutions. However, *my* first priority is to local communities and economies that are served by community banks. We must work together to ensure a system where both types of institutions thrive.

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So while there are promising examples of regulatory right-sizing taking place, there remains a push in Washington to reform our regulatory structure to better reflect the business models of our largest banks. The solution for these supporters is to consolidate supervisory authority into one behemoth federal agency. I believe these advocates truly think the best financial system for the United States is one that caters to a handful of large, complex, internationally competitive financial firms.

I disagree. We don't need a system that caters to a handful of banks. We need a system that allows you to serve your customers, small businesses, and local and state economies. This is the real strength of our financial system and of our economy.

## Conclusion

The future of community banking is not just about the future of community banks, but the future of our communities and our state. The future is about the ability of our state to control its own economic destiny through its regulation of state–chartered financial institutions.

We have inherited an important legacy—a diverse banking system. The Department of Financial Institutions is committed to working with you and national leaders to protect and strengthen this legacy. ■