

Supervisory Spotlight

A Regulator's Perspective on Issues Facing Western Banks



December 2014



Greetings!

As we wrap up another year, I always like to take a moment with my team to look back and celebrate our successes and identify the lessons we learned from confronting our challenges. I thought I'd take the same approach with this issue of Supervisory Spotlight.

As discussed in more detail in the third quarter 2014 issue of [First Glance 12L](#), the Twelfth District's economy has continued to expand at a healthy rate, and Leading Index readings from the Federal Reserve Bank of Philadelphia suggest growth will continue in most of the District's states. Mirroring economic growth, loan growth continued to expand and asset quality measures are approaching pre-crisis levels. Examination rating trends also reflect this improving financial condition, with the average asset quality component rating showing the most improvement since the depth of the crisis. I'm sure that you share our interest in ensuring that asset quality measures continue to improve and remain strong; we hope that the [Community Banking Connections](#) article "[Development and Maintenance of an Effective Loan Policy: Part 1](#)" helps you attain that goal.

The improving financial condition of most district banks has allowed bank management to refocus their attention on operational risks. One of the risks receiving regulatory attention is how banks manage their third-party vendor relationships. The [Community Banking Connections](#) article "[Managing Service Provider Relationships and Risks](#)" discusses frequently asked questions about the Federal Reserve's "[Guidance on Managing Outsourcing Risk](#)." As this guidance notes, generally, the level of outsourcing risk is aligned with the size and complexity of the institution. While community banks usually have fewer service provider relationships, they are sometimes reliant on a concentration of a few key service providers, which creates risk in and of itself.

Cybersecurity may be the operational risk on most bankers' minds. In November, the FFIEC released observations from a recent community bank cybersecurity assessment and recommended that financial institutions participate in the [Financial Services Information Sharing and Analysis Center \(FS-ISAC\)](#). The [cybersecurity assessment](#) overview suggests questions that CEOs and board members may consider when assessing their institutions' cybersecurity preparedness. As part of your cybersecurity assessment, you should also carefully consider the [FFIEC agencies' recommendation](#) that financial institutions of all sizes participate in the FS-ISAC as part of their process to identify, respond to, and mitigate cybersecurity threats and vulnerabilities.

While we focus on today and the future, we shouldn't forget the lessons of the past. In the [View from the District](#) in the third/fourth quarter 2014 issue of [Community Banking Connections](#), Michael Johnson from the Atlanta Fed (and formerly with us in San Francisco) discusses the factors that contributed to the high concentration of bank failures in Georgia and Florida and some of the lessons learned during the crisis. As I read that article, I was struck by how similar the southeast banking profile was to the profile in the west. This is definitely food for thought in the future.

The third quarter 2014 issue of [Consumer Compliance Outlook](#) also looked to the past when considering the future. The article, "[Community Reinvestment Act: Developing a Strategy for Success](#)" looks at the evolution of CRA and offers suggestions for developing a comprehensive CRA strategy. Another article in that issue, "[Consumer Compliance Management Program — Common Concerns and Best Practices](#)" includes additional perspectives on the [Community Bank Risk-Focused Consumer Compliance Supervision Program](#). Appropriate management attention to both CRA and consumer compliance issues will reduce the likelihood of a repeat of the uptick in less than satisfactory ratings that we saw during the financial crisis.

One last thought... did you know that the Federal Reserve and CSBS hosted their second annual [Community Banking in the 21st Century](#) conference in September? 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. The [conference summary](#) provides a good overview of the discussions and may pique your interest in some of the more detailed research papers and presentations.

As always, I appreciate feedback and suggestions for topics that are of particular concern to your institutions.

Best regards,

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