SPEECHES

Benefits of Dual Banking System Supervision in Uncharted Waters

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“Benefits of Dual Banking System Supervision in Uncharted Waters”

Conference of State Bank Supervisors
President and CEO Brandon Milhorn
Keynote Remarks
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Introduction

Thank you for that kind introduction. I would like to thank President Raphael Bostic and the Atlanta Fed for the invitation to participate in this important and timely conversation.

Someone . . . who is clearly clairvoyant . . . gave a title to this session a few months ago: “Benefits of Dual Banking System Supervision in Uncharted Waters.”

These are certainly interesting times for the dual banking system, and the waters do seem a little turbulent and choppy at the moment. But perhaps they are not completely uncharted:

Jefferson and Hamilton….

Jackson and the Second National Bank….

Lincoln, the National Bank Act, and the OCC….

The creation of the Federal Reserve System and the FDIC….

And, since then, nearly endless debates about the appropriate role of the states and the federal government in the regulation and supervision of our financial system.

Since 1902, the Conference of State Bank Supervisors (CSBS) has served as the representative of state financial regulators from across the nation. Our members span all 50 states, the District of Columbia, and the territories. They charter, license, regulate, and supervise the institutions — both bank and nonbank — that provide financial services to the consumers, small businesses, and farmers that form the fabric of their local communities and, in

aggregate, our nation's economy. Our members have been fighting for the dual banking system for ages.

The Importance of the Dual Banking System

I, on the other hand, am relatively new to this centuries-old debate. Before joining the FDIC in 2018, I was a national security lawyer. I like to think that my background gives me an outsider's perspective on the topic . . . a little intellectual neutrality . . . and, I often find myself coming back to a simple question: why does it all matter?

Now, this audience is invested in the dual banking system, and I am almost certain none of you woke up last night, in a cold sweat, and shouted, "We must protect the dual banking system!" And, I often wonder if most Americans – like my Mom and Dad in Tennessee or my two sons – even know what the dual banking system is . . . or ever consider how it impacts their lives every day.

But, it does . . . and we should talk about why that matters.

When you bought your coffee this morning, paid your mortgage last night, and set up your Amazon delivery for the weekend, you took advantage of a complex, nationwide financial infrastructure. Banks and financial institutions of all shapes and sizes, credit card issuers, mortgage originators and servicers, payment processors, and fintechs . . . any number of financial service providers played a role in these transactions. You see a debit on your bank statement and hold a product in your hand. But, behind the scenes, state and federal regulators are working to promote a safe, sound, and stable financial system and protect your rights as a consumer.

The Debate

From the beginning, there has been a fundamental . . . and sometimes awkward . . . tension between the federal government and the states on financial and economic issues. This tension derives from our Founding Fathers' commitment to decentralized power and economic self-determination. Those core values carry over into our financial regulatory system — balancing national interests with local needs.[1]

Our federal partners in Washington, D.C., have a national perspective on supervision and regulation, driven by a desire for financial stability and an underlying instinct to mitigate . . . or attempt to eliminate . . . financial risk. The states share concerns for safety, soundness, and consumer protection, but they also want their communities to grow and their local economies to thrive.

This balancing of financial risk and economic opportunity . . . and the separate perspectives of federal and state regulators on how this balance should be appropriately struck . . . sits at the heart of the debate over the dual banking system. The disparate views of state and federal regulators create a healthy tension in the development of the rules and procedures that govern our financial system.

A Uniquely American System

Banks, in particular, have the ability to choose how they are chartered, regulated, and supervised. State banks are chartered and overseen by state regulators, with joint supervision by the Federal Reserve or FDIC depending on whether they are Federal Reserve member banks. National banks are chartered and supervised by the OCC. The Federal Reserve also oversees bank holding companies.

Faced with this choice, 79% of banks have chosen a state charter.[2] These banks prefer the local perspective and accountability that accompanies their supervision by the states. They prefer a state supervisor's understanding of local economic conditions and markets.

Most of these state-chartered banks . . . well over 90% . . . are also community banks that have a relationship-based business model.[3] They know the farmers they are lending to . . . they know the entrepreneur that is trying to open a new small business . . . they understand local economies.[4] In one-quarter of U.S. counties, a community bank is the only physical banking presence.[5] If small businesses are the engines of the U.S. economy, community banks are the jet fuel.[6]

We have more than 4,400 banks in the United States. Most countries have far fewer, but those models would never work here. Large money-center banks, and even regional lenders, simply cannot reach the rural, inner-city, and underserved markets that community banks serve.

When a community bank closes, local residents suffer, particularly low-income households.[7] But when these banks thrive, local economies grow, and consumers have more choice in how they access and use financial services. That is why state supervisors are so invested in the success of community banks.

The Health of Community Banking

Our nation's community banks are under tremendous pressure. Over the last 10 years, we have lost 33% of these banks – 2,000 institutions that were either merged, bought, or simply closed.[8] Over that same period, very few new banks have formed to take their place.[9]

Some of the threats facing community banks are driven by markets and consumer demand: new competitors, the race to find new capital and deposits, costly new technologies, and the constant need to hire and retain more and more skilled personnel.[10]

But federal policy has also created undue pressure on the community banking business model . . . including a wave of extensive, new regulatory mandates over the last few years.[11] Even when these regulations were targeted at larger institutions, we have often seen the requirements filter down through supervisory expectations. This "supervisory creep" is a real and costly reality for community banks.[12]

To breathe new life into the community banking business model, our federal partners must reset their approach.[13]

We must move away from process-driven, checklist-oriented supervision and focus on core financial risks. Our approach to BSA/AML would be a good place to start.

We must tailor regulation and supervision to the size and complexity of institutions, particularly for community banks. Regulations must be well-designed and carefully calibrated, and the cost of imposing new requirements and reporting obligations must be weighed against real and articulable benefits. Arbitrary regulatory thresholds that prevent banks from growing with their communities should be abandoned,[14] and "supervisory creep" must be stopped.

We must revise our regulatory framework to foster new technologies and new business models. The federal banking agencies should revisit vague regulatory guidance around third-party partnerships, particularly when those partners are engaged in core banking functions like deposit taking, payments, custody, or lending. Community banks need a clear operational roadmap to successfully innovate.

We must also change the way federal agencies review *de novo* applications, and adopt new standards that support healthy merger activity, especially for local/local mergers of community banks.

I am encouraged by preliminary signals from the new Administration. Acting FDIC Chairman Travis Hill and Acting Comptroller Rodney Hood have discussed regulatory and supervisory approaches that are very much aligned with the views of CSBS.[15] Fed Governor Miki Bowman – a former state supervisor from Kansas – has also expressed strong, sensible views on these issues.[16]

An Existential Threat to the Dual Banking System

I have talked about the different perspectives of state and federal supervisors, why community banks are so important to state supervisors, and why we must rethink the federal regulatory and supervisory environment to promote the continued vitality of the community bank business model.

I would be remiss, however, if I did not discuss one growing threat to the dual banking system – a proposal being discussed in the press to consolidate federal regulatory and supervisory responsibilities into one agency.[17]

Almost immediately after the Federal Reserve was created, pundits and policymakers began debating the consolidation of federal supervision of banks into one agency. The debate has waxed and waned for over 100 years. Proponents have argued for consolidation at the Federal Reserve . . . at the FDIC . . . or at the OCC. Every time it has been raised, the creation of a monolithic federal regulator has been rejected.[18]

Why? Because the different perspectives of state regulators compared to our federal counterparts . . . and disagreements among the federal regulators themselves . . . help produce robust debate and more thoughtful federal regulations and standards. This process can be cumbersome and time-consuming for rulemaking – particularly when the FDIC, OCC, and the Fed must all agree on joint rulemakings – but these deliberations can prevent bad proposals from becoming bad regulation.

These differences and disagreements make the choice of a charter more meaningful. They serve as regulatory checks and balances. They allow for a diverse financial system and help promote a more tailored regulatory and supervisory environment.

A single, all-powerful federal regulator would destroy the benefits of this democratic competition of ideas. Banks that chose a state charter would almost certainly be disadvantaged in this one-regulator model, and the diversity of our financial system and the health of community banks would be collateral damage.

A consolidated federal regulator would be responsible for supervision and regulation of nearly 4,500 institutions ranging in size from $4 trillion to $3.3 million.[19] One-size-fits-all federal regulation and “supervisory creep” are problems under the existing system. Does anyone seriously believe that these problems would be better under one massive federal regulator?

I am also quite concerned about the impact this consolidation could have on the politicization of federal regulation. Wild swings in supervisory expectations and regulatory requirements undermine stability and certainty for financial institutions and pose a special hardship for community banks. Banks faced with these extreme changes incur significant legal, operational, and technological costs to meet new, ever-changing compliance demands. Consolidated federal supervisory and regulatory authority – in a single agency with a single leader – will almost inevitably lead to further politicization of federal oversight of financial services, at the expense of certainty, stability, and innovation.

Conclusion

The U.S. regulatory framework – with the dual banking system at its core – has fostered the most diverse, innovative, and dynamic financial services sector in the world. It is the cornerstone of America's $27 trillion economy.

This system relies on cooperative federalism. It requires coordination between state and federal bank regulators. When implemented effectively, this cooperation can create an efficient and complementary regulatory and supervisory framework for our nation's banks.

I am proud of the role our CSBS members play in safeguarding the dual banking system. And, whether your customers know it or not, they are the beneficiaries of the efforts of these state supervisors every single day.

Thank you. I look forward to our discussion and your questions.

Endnotes

1 *See* Brandon Milhorn, *Keynote Remarks before the American Bar Association Banking Law Committee* (Jan. 19, 2024).

2 As of 12/31/24, states chartered 3,551 of the nation's 4,482 banks.

3 As of 12/31/24, there were 3,273 state-chartered community banks out of 3,551 state-chartered banks. CSBS uses the FDIC's research definition to classify institutions as community banks. That definition takes into account an institution's size, geographic footprint, business model, and other characteristics. *See* FDIC, *Community Banking Study*, Appendix A: Study Definitions (Dec. 2020).

4 *See* Luke Petach, Stephan Weiler & Tessa Conroy, *It's a Wonderful Loan: Local Financial Composition, Community Banks, and Economic Resilience*, 126 J. Banking & Fin. 106077 (2021).

5 Matt Hanauer, Brent Lytle, Chris Summers & Stephanie Ziadeh, *Community Banks' Ongoing Role in the U.S. Economy*, 106 Econ. Rev., Federal Reserve Bank of Kansas City (2021).

6 Collectively, community banks represent about 11% of banking industry assets, yet they fund 37% of all small loans to businesses and 63% of bank-originated agricultural loans nationwide. FFIEC, Central Data Repository.

7 *See* Erik J. Mayer, *Big Banks, Household Credit Access, and Intergenerational Economic Mobility*, 59 J. of Fin. & Quant. Analysis, 2933 (Sept. 2024).

8 In 2014, there were more than 6,100 community banks. At the end of 2024, there were about 4,050. FDIC, BankFind Suite.

9 FFIEC, National Information Center; *see also* Testimony of Arkansas State Bank Department Commissioner Susannah Marshall, "Make Community Banking Great Again," Hearing Before the U.S. House Committee on

Financial Services, 119th Cong. (Feb. 5, 2025) ("Only 62 *de novo* community banks were formed over [the last 10 years].").

10 In 2024, 89% of community bankers cited government regulation as the highest external risk they face, tying for first with the rising cost of funds. The share of community bankers listing regulation as an "extremely important" or "very important" risk has risen consistently over the last few years, up from 81% in the 2023 CSBS Annual Survey and from 77% in the 2022 survey. *See* CSBS, *2024 CSBS Annual Survey of Community Banks*, Presented at the 12th Annual Community Banking Research Conference (Oct. 2-3, 2024). Community banks responding to the Third Quarter 2024 Community Bank Sentiment Index survey noted government regulation, cyber threats, and the cost/availability of labor among their top concerns. *See* CSBS, *Community Bank Sentiment Index* (Oct. 8, 2024); *see also* Marshall Testimony, *supra* note 9.

11 *See* Marshall Testimony, *supra* note 9 ("In 2024 alone, the federal banking agencies proposed or finalized more than 30 rules totaling more than 4,000 pages." (citing CSBS Board Chair Charlie Clark,*Opening Remarks by CSBS Chair Charlie Clark at the 2024 Community Banking Research Conference*, St. Louis (Oct. 2, 2024)).

12 *See* Clark Opening Remarks, *supra* note 11.

13 *See* CSBS, Letter to Congressional Leadership Re: State Regulators' Priorities (Jan. 16, 2025); *see also* Marshall Testimony, *supra* note 9.

14 A significant number of regulations have static thresholds that do not keep pace with economic or industry growth. For example, the $10 billion CFPB supervision threshold was established in 2010, and independent audit, internal control attestations, and reporting requirements in 12 C.F.R. Part 363 have not been updated since 2009. *See* Congressional Research Service, *Over the Line: Asset Thresholds in Bank Regulation* (May 3, 2021); *see also* Marshall Testimony, *supra* note 9.

15 *See* FDIC Acting Chairman Travis Hill, *Charting a New Course: Preliminary Thoughts on FDIC Policy Issues* (Jan. 10, 2025); OCC, *Rodney E. Hood Announced as Acting Comptroller of the Currency* (Feb. 7, 2025); *see also* CSBS Letter to Congressional Leadership, *supra* note 13.

16 *See* FRB Governor Michelle Bowman, *Bank Regulation in 2025 and Beyond* (Feb. 5, 2025).

17 *See* Gina Heeb, Brian Schwartz, and AnnaMaria Andriotis, *Trump Advisers Eye Bank Regulator Consolidation After Targeting CFPB*, The Wall Street Journal (Feb. 11, 2025); *see also* Evan Weinberger, *Trump Gets Ready to Move Bank Regulators After Workforce Purge*, Bloomberg Law (Feb. 19, 2025).

18 *See* Remarks by CSBS CEO John W. Ryan, *The Banking System We Need* (Nov. 1, 2013) ("Offered the opportunity to install a single federal regulator, Congress has declined to do so time and time again: They declined in 1914, when an original goal of the Federal Reserve Act was to create a single, unified federal bank regulator; they declined in 1971, when President Nixon's Hunt Commission recommended reducing the number of federal banking agencies from five to two, including a federal Administrator of State Banks; they declined in 1984, when President Reagan's Task Force on Regulation of Financial Services proposed ending the FDIC's

regulatory and supervisory authority; they declined in 1991, when Treasury's original proposal for FIRREA called for dividing federal bank supervisory authority between the Fed and a new, consolidated Federal Banking Agency; they declined in 2008, when Treasury Secretary Paulson envisioned a new regulatory triumvirate that would have vested all safety-and-soundness supervision in a single agency; and they declined in 2010 when Senate Banking Committee Chairman Dodd proposed several variants of consolidation throughout the course of the Dodd-Frank debate.").

19 FFIEC, National Information Center.