



Community Banking | 2017 in the 21st Century

FEDERAL RESERVE / CONFERENCE OF STATE BANK SUPERVISORS
Community Banking Research and Policy Conference

Community Banking in the 21st Century

Fifth Annual Community Banking Research and Policy Conference
Co-sponsored by the Federal Reserve System and the Conference of State Bank Supervisors
Oct. 4-5, 2017, at the Federal Reserve Bank of St. Louis



Acknowledgements:

This publication was made possible by the collaborative efforts of state bank supervisors, community banks, the Conference of State Bank Supervisors and the Federal Reserve System. The *Community Banking in the 21st Century* National Survey was administered by state bank commissioners in 37 states. A total of 611 community bankers participated in the survey. Interviews with community bankers, referred to in this publication as “Five Questions for Five Bankers,” were conducted by state bank supervisors in 30 states from April to July. Participation in both the 2017 National Survey and the “Five Questions for Five Bankers” discussions would not have been possible without the efforts of the following state bank commissioners and members of their staff:

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Letter from Jerome H. Powell

This year marks five years since the Federal Reserve and the Conference of State Bank Supervisors (CSBS) formed a vital partnership to promote academic research on community banking. In this short span of time, the industry has evolved significantly. At the time of the first conference in 2013, there was focused concern about the potential impacts of post-Dodd-Frank rules and regulations on the industry. While there is still concern about regulatory burden, the top issue has shifted. Today's community bankers are struggling to understand the technological innovations that may require investment in upcoming years.

The findings from this year's survey, facilitated by the state bank commissioners and the CSBS, allow us to better understand where community banks see the greatest opportunities and challenges facing their industry. More than 600 community bankers from across the U.S. lent their voices to this year's survey, and those views are captured in this volume.

The survey has taken on even greater importance, as researchers are now using the survey data to help answer research questions that will improve our understanding of this ever-changing industry. The quantitative information is melded with anecdotal insights gleaned from conversations between state bank commissioners and bankers in their states. The combination adds to the richness of this publication.

The Federal Reserve looks forward to continuing this partnership with the CSBS and growing its understanding of our nation's community banks.

Jerome H. Powell

Governor

Federal Reserve Board of Governors

Chair, Subcommittee on Smaller Regional and Community Banking

Foreword from Albert L. Forkner

As state regulators, we supervise a wide range of financial institutions—everything from large commercial banks to start-up fintechs. But the core of state regulation has always been community banks, the local institutions that finance Main Street businesses, provide essential banking services in our neighborhoods, sponsor Little League baseball teams and go into schools to teach young adults about how to manage their finances.

And we are right in wanting to preserve this form of financial services.

That is why I am encouraged by the results in this year's survey of community bankers, which suggest that the sector, after many years of tumult, might be achieving stability. Commercial lending propelled portfolio growth last year. Community banks remained a strong source of business lending. And they had an active year in mortgages and home equity. Moreover, community banks saw greater opportunities for business growth.

Combined, these and other results are a testament to the staying power of the relationship lending business model.

To be sure, community banks have their challenges. Economists at the Federal Reserve Bank of St. Louis calculate that, in 2016, compliance costs once again increased over the prior year, from \$5.0 billion to \$5.4 billion. And the survey suggests that recent federal mortgage regulations might be depressing credit availability.

Understanding these and other implications is why the Conference of State Bank Supervisors partners with the Federal Reserve to host an annual research conference on community banking. We look forward to hearing the insights of economists, academics, financial regulators and other thought leaders.

In an era when banking might be becoming too disconnected from the communities they serve, community banks are an essential source of credit and banking services for families and neighborhoods everywhere.

Albert L. Forkner

Chairman, Conference of State Bank Supervisors

State Banking Commissioner, Wyoming Division of Banking

2017 National Survey

2017 National Survey

Introduction

The evolution of community banking in the aftermath of the recession was profound, enduring and, at times, painful. Profitability plummeted, as did the number of banks and, to a lesser extent, bank branches. New regulations were enacted.

The Federal Reserve System and the Conference of State Bank Supervisors (CSBS) have been at the forefront of examining these issues. Now in its fifth year, the *Community Banking in the 21st Century* research and policy conference has offered an opportunity to bring together academic experts, federal and state policymakers, and community bankers to explore relevant topics and the pivotal role of community banking in both local markets and the national economy.

This year's report is based on a national survey of more than 600 community banks. It is supplemented by summaries of interviews conducted by state bank commissioners. These summaries, broken down by each of the 30 states that participated, can be found in the next section of this volume.

The opinions of bankers, in both the survey and interviews, point to a possible transition from the troubles of the past to a healthier future. They describe a retrenchment, wrought over the past several years, that is believed to have restored a competitive balance offering opportunities as well as challenges. In this regard, many bankers noted that mergers, acquisitions and failures are allowing them to grow loan portfolios and to gather new business and municipal relationships.

"There are fewer and fewer bank competitors and even fewer still that are locally based," one survey respondent said. "We feel that this bodes well for those that remain."

More evidence of transition, or at least potential transition, stems from Congress, whose agenda includes deregulatory objectives. This was reflected in the thematically aligned, but discordant, comments of two community bankers, one excited about the "possibility of real regulatory relief" and another worried about the "possibility of no regulatory relief."

Signs of actual regulatory relief were not yet apparent in our survey results. Mean levels of compliance expenses in various operational categories, expressed as percentages of overall costs, were higher this year than last year. There may be some consolation for community bankers, however, in that cost increases were reported as slowing despite the imposition of one-time expenses associated with implementation of new mortgage rules. Overall, inferred compliance costs for community banks increased from \$4.5 billion in 2014 to \$5.0 billion in 2015 and then to \$5.4 billion in 2016.

Differences between what may happen and what has happened also emerged in bankers' opinions of financial technology (fintech) companies. Although fintech is not perceived as a current competitive threat for most products and services, its role is expected to increase dramatically in the future. From this perspective, some bankers see technological innovation as an opportunity, while others view its adoption as an obligatory and expensive response to marketplace pressures. This latter group, in particular, noted challenges in "keeping pace with technology while maintaining personal service."

With respect to small business lending, survey respondents similarly expect increased competition from fintech firms, as well as from credit unions. This appears particularly inauspicious insofar as the volume of these loans contracted last year across the community banking industry. The fundamental earnings model of community banks may be "sound," as at least one study concluded,¹ but the role of small business lending within this model appears to be changing.

Endnotes appear on Page 31.

Background on the Survey

Community banks are generally regarded as having two key characteristics: They are small in size, and they conduct most of their business in their local communities. Since passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), it has become common practice to define community banks as institutions with less than \$10 billion in assets. We adopt the Dodd-Frank standard for the purposes of this report.

To develop the 2017 National Survey, staff members of the CSBS met with representatives from several Federal Reserve banks, the Federal Reserve Board of Governors and the academic community to identify current issues of relevance to community banks. Many, but not all, of the resulting questions were similar to those asked in last year's survey, thereby offering an opportunity to compare responses over time. The questions involved lines of business, regulatory compliance, competition and consolidation. Small business lending, in particular, was highlighted.

The survey was distributed by state banking regulatory agencies in April and remained open through July.² Our final sample consisted of 611 responses from community banks in 37 states. In 2016, we received 557 responses from 26 states.

Participation varied by state (Figure 1). The unequal geographic distribution raises potential issues with respect to survey bias—that is, with how representative our respondent banks may be of the community banking industry overall. To address these issues, we compared characteristics of respondent banks with the same characteristics of all banks with assets under \$10 billion for which information is available in the Consolidated Reports of Condition and Income (Call Reports). We limited comparisons to state-chartered banks since more than 90 percent of the institutions in our sample were in this category.³

Tables 1 through 3 provide information on asset size, number of branches and geographic diversification, respectively, for respondent banks and for the industry in general. Banks in the smallest size categories that participated in the survey tended to be underrepresented relative to

FIGURE 1
Community Bank Participation by State

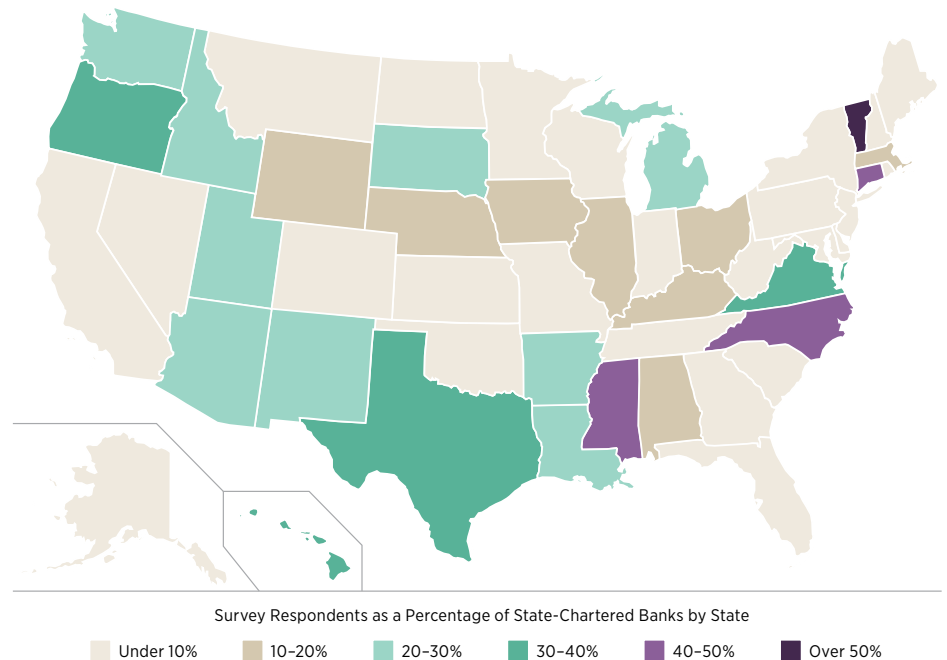


TABLE 1
Bank Asset Size Categories

What was the asset size of your bank as of Dec. 31, 2016?	Banks in Survey		All State-Chartered Community Banks	
	Number	Percent	Number	Percent
Up to \$50 Million	34	5.68%	461	10.29%
\$50 Million to \$100 Million	78	13.02%	746	16.66%
\$100 Million to \$300 Million	234	39.07%	1,685	37.63%
\$300 Million to \$1 Billion	189	31.55%	1,118	24.97%
\$1 Billion to \$2 Billion	36	6.01%	255	5.69%
\$2 Billion to \$10 Billion	28	4.67%	213	4.76%
Greater than \$10 Billion	0	0.00%	0	0.00%

TABLE 2
Branching

How many branches does your institution currently have?	Banks in Survey		All State-Chartered Community Banks	
	Number	Percent	Number	Percent
0 (Headquarters Only)	77	12.85%	891	19.90%
1-5	302	50.42%	2,337	52.19%
6-10	119	19.87%	638	14.25%
More than 10	101	16.86%	612	13.67%

the industry as a whole. In this regard, banks with less than \$50 million in assets represented less than six percent of those in our survey but 10 percent of all community banks (Table 1). Sampled banks had a greater number of branches relative to the industry (Table 2) but comparable geographic reach in terms of the number of states in which they operated (Table 3).

More detailed statistical testing would be required to definitively quantify the extent to which surveyed banks are representative. Observed differences, however, do not appear to be conspicuous with respect to our chosen comparative metrics.

Community Banks: What They Do

We asked community bankers to describe the various activities of their banks as a way of defining their business models. Special attention was devoted to small business lending—what is often described as the “lifeblood” of community banking.

Small Business Loans

Small business loans are valuable to small firms in providing access to credit and protecting against adverse economic shocks.⁴ These loans also are valuable to banks as a means of capturing information about borrowers and local business conditions that can lead to other opportunities. Such interdependencies are inherent in the reliance of small businesses on banks, from which they receive 90 percent of their financing—triple the percentage of larger firms.⁵ And they are similarly evident in the reliance of banks on small businesses: Nearly 98 percent of the community banks in our survey reported making small business loans.

Small business loans are defined in Call Report instructions as commercial and industrial loans, as well as loans secured by nonfarm, nonresidential properties, that have original amounts of \$1 million or less. Bankers, on the other hand, have somewhat different perspectives (Figure 2). Although more than 30 percent of survey respondents defined small business loans on the basis of denomination, nearly as many shifted the perspective from loan size to borrower type, defining loans in terms of total business revenue or number of employees. An even larger percentage, nearly 38 percent, was completely

TABLE 3
Geographic Diversification

In how many states does your bank operate?	Banks in Survey		All State-Chartered Community Banks	
	Number	Percent	Number	Percent
1 State	528	88.14%	4,047	90.38%
2 States	57	9.52%	323	7.21%
3 States	2	2.00%	64	1.43%
4 States	1	0.17%	26	0.58%
5 States	0	0.00%	10	0.22%
6 or More States	1	0.17%	8	0.18%

FIGURE 2
Bankers' Definitions of Small Business Loans

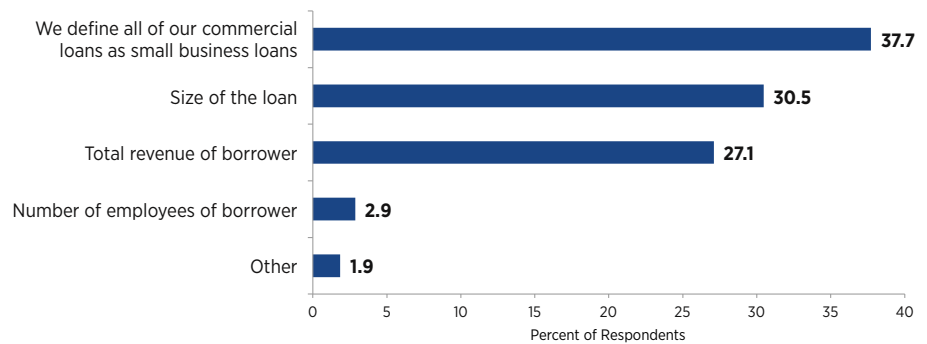


FIGURE 3
Importance of Financial Statements to Small Business Lending

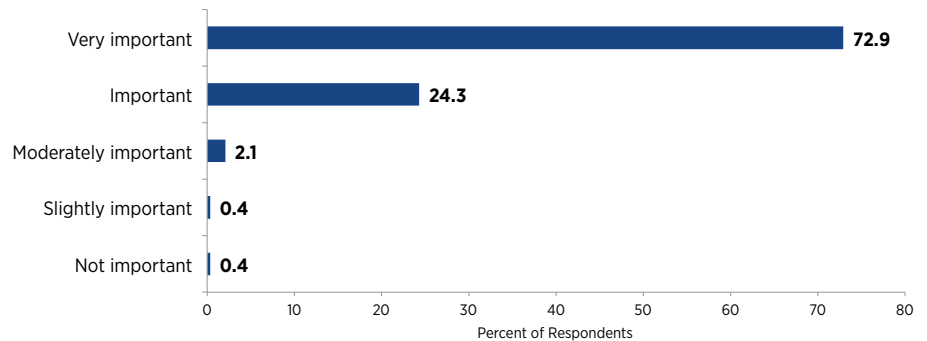
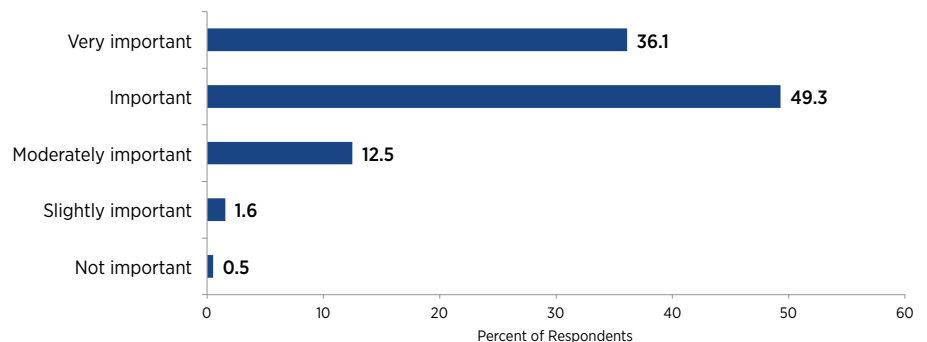


FIGURE 4
Importance of Business Assets to Small Business Lending



indiscriminate, defining any commercial loan as a small business loan.

Factors in Small Business Lending

Bankers were asked to respond to questions about the factors they considered when making small business loans. Turning first to characteristics of the businesses themselves, more than 80 percent of bankers considered financial statements (Figure 3) and assets (Figure 4) to be either very important or important. The credit scores of businesses, on the other hand, were deemed to be very important or important by only 34 percent of bankers (Figure 5).

In contrast to the de-emphasis on business credit scores, the credit scores of *business owners* were considered to be very important or important to 85 percent of respondents (Figure 6). This appears to underscore the focus of community banks on both personal knowledge and quantitative assessments. As one banker said, “For borrowers with credit scores higher than 720, the loans should write themselves, with technology reserving the bank’s resources for the more difficult and complex credits.”

Some bankers cast the encroaching technology of credit scores as a challenge. “One large bank claims to be able to fund loans up to \$250,000 the next day,” one banker said. “We will be left with only the lesser quality (riskier) borrowers that don’t qualify for the algorithm/pixie-dust-in-the-magic-box loan approval.”

It was surprising to observe other factors that high percentages of community bankers seemed to exclude from the loan evaluation process. General business conditions, for instance, were considered unimportant, slightly important or moderately important by more than 25 percent of respondents (Figure 7). Apparently, these banks focus their attention on individual borrowers rather than on the economies within which they operate.

The importance of prior relationships to small business lending was evident in the nearly 70 percent of respondents reporting that greater than 60 percent of their new small business loans in 2016 were made to borrowers with a previous deposit or lending relationship (Figure 8). The potential for future relationships also was a factor,

FIGURE 5

Importance of Business Credit Scores to Small Business Lending

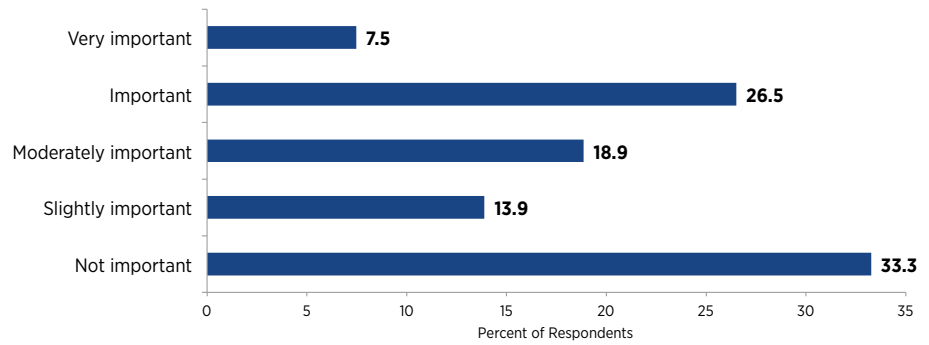


FIGURE 6

Importance of Business Owners' Credit Scores to Small Business Lending

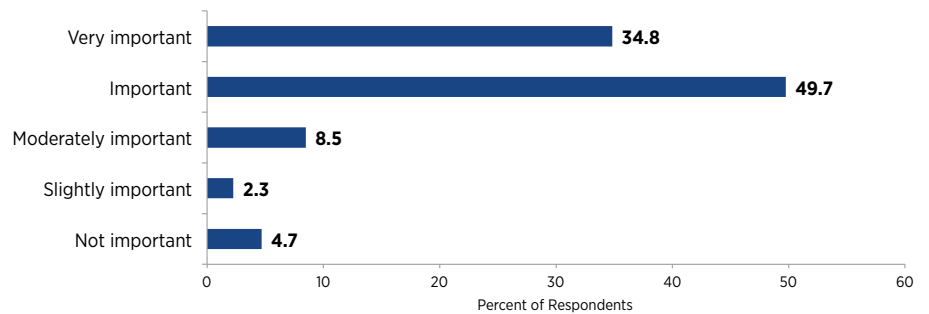


FIGURE 7

Importance of General Business Conditions to Small Business Lending

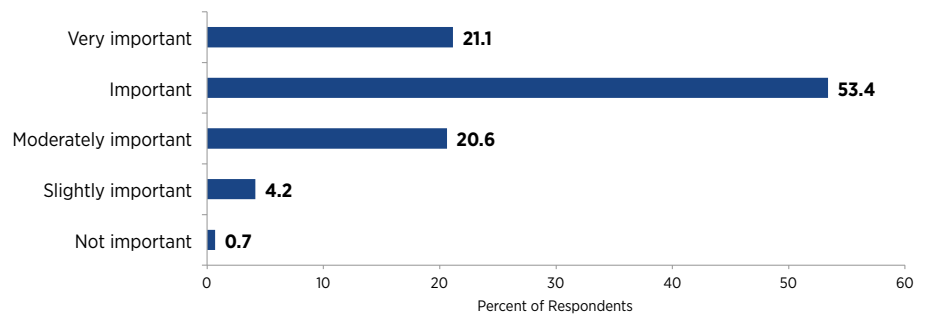
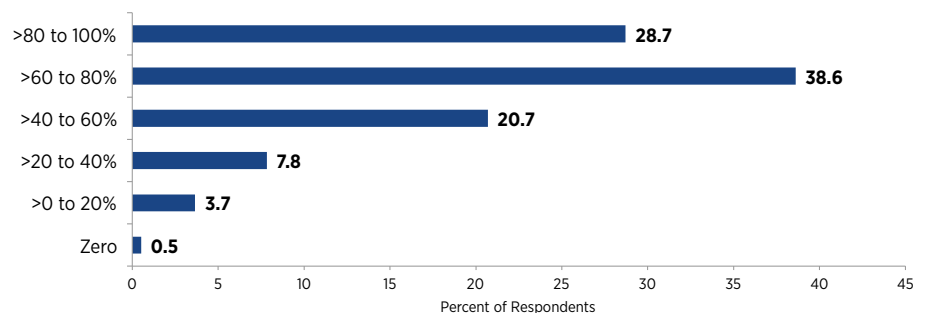


FIGURE 8

Percentage of Small Business Loans Made to Prior Banking Relationships



NOTE: Results are for loans originated in 2016.

with more than 76 percent of respondents stating that this was very important or important (Figure 9).

Prior lending relationships, more so than prior deposit relationships, played an integral role in lending decisions in 2016. Seventeen percent of respondents said that previous deposit relationships were either unimportant or only slightly important in small business lending, while only 12 percent considered them to be very important (Figure 10). For prior lending relationships, the situation was different: Only about 11 percent of respondents said that these relationships were either unimportant or only slightly important, while nearly 25 percent said they were very important (Figure 11).

New questions this year concerned the provision of collateral, or secondary sources of repayment that can be sold if the cash generated by the borrower is insufficient to repay the loan. The importance of collateral is underscored by its ubiquity in lending decisions, with 95 percent of banks reporting that they never, or rarely, offered uncollateralized loans.

Survey respondents indicated that collateral provided by the business, rather than by the business owner, is more important to lending decisions (Figures 12 and 13). Nearly 50 percent of those surveyed said that business collateral was a very important factor, compared with about 20 percent for personal collateral of the business owner. In terms of the actual backing of loans, business collateral, rather than the collateral of the business owner, also took prominence: 95 percent of respondents said that small business loans were always or usually backed by business collateral, while less than 40 percent said that these loans were backed by personal collateral (Figures 14 and 15).

Banks also often require guarantees when extending small business loans (Figure 16). This is consistent with results reported in small business credit surveys.⁶ It also is consistent with the comments of many bankers who identified personal guarantees as an important factor in decision-making. As one respondent noted, “We get as much collateral as we can.”

Small business loans guaranteed by the Small Business Administration (SBA)

FIGURE 9

Importance of Potential Future Relationship to Lending Decisions

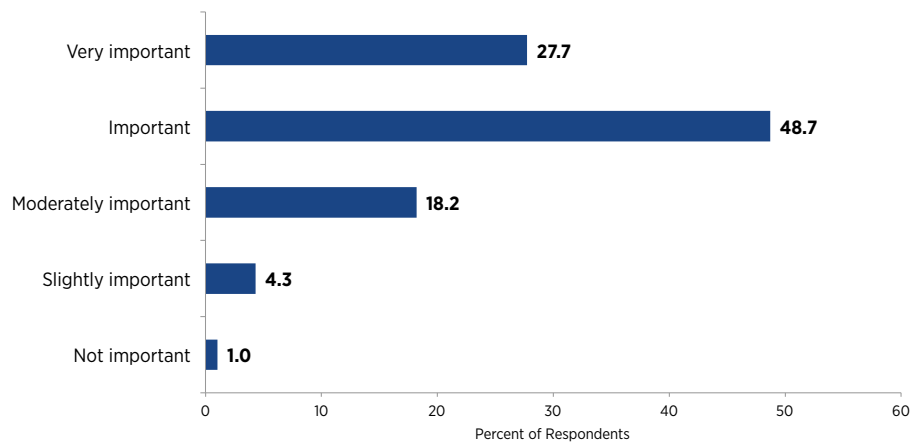


FIGURE 10

Importance of Prior Deposit Relationship to Lending Decisions

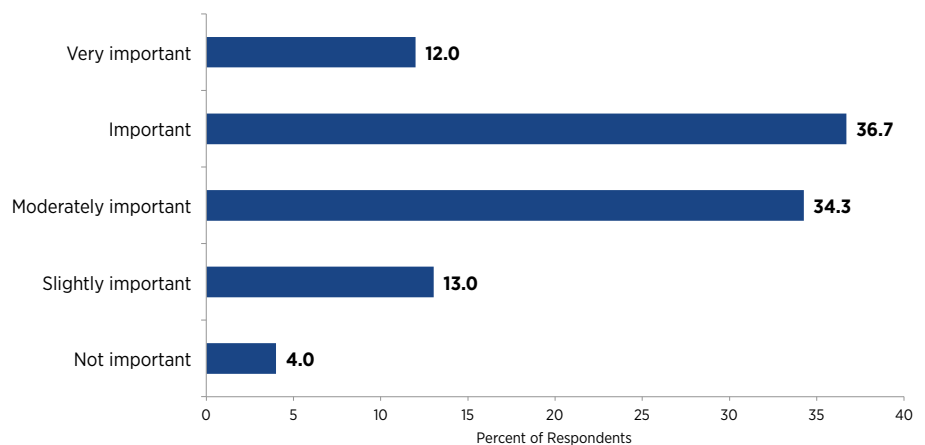


FIGURE 11

Importance of Prior Lending Relationship to Lending Decisions

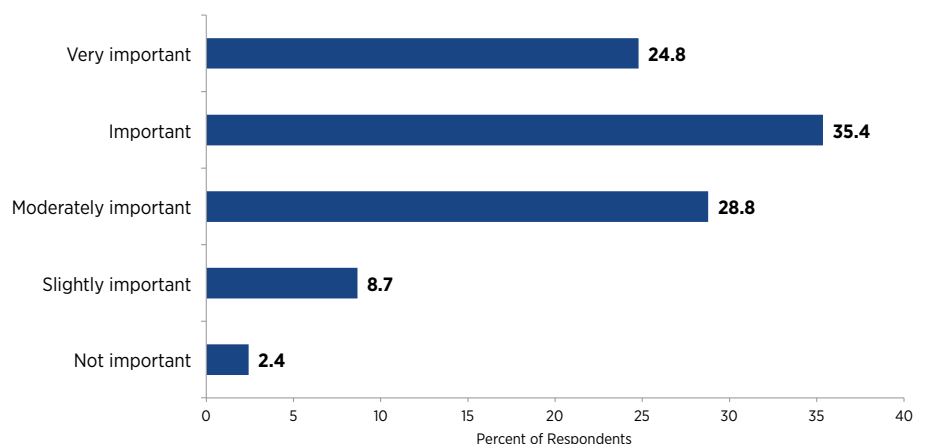


FIGURE 12

Importance of Business Collateral to Lending Decisions

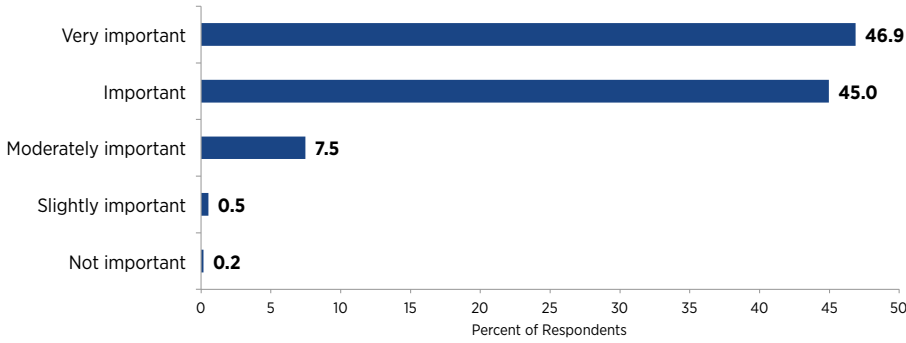


FIGURE 13

Importance of Business Owners' Collateral to Lending Decisions

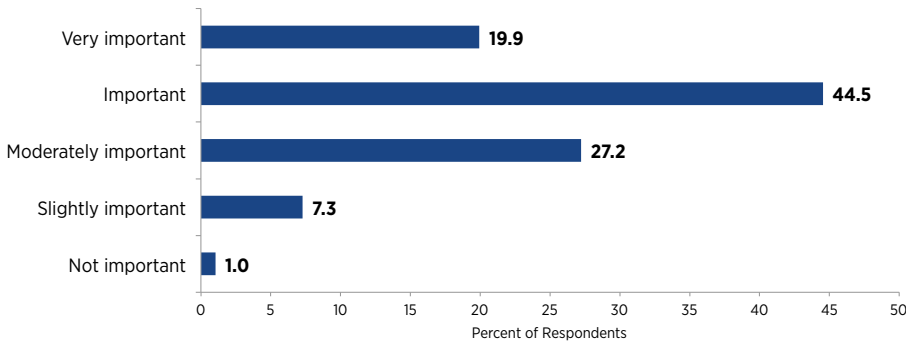


FIGURE 14

Frequency of Small Business Loans Backed by Business Collateral

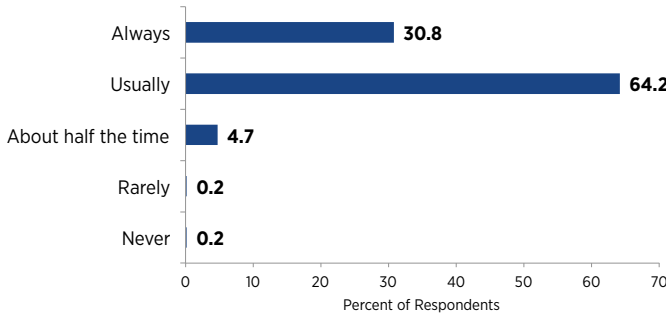


FIGURE 15

Frequency of Small Business Loans Backed by Business Owners' Collateral

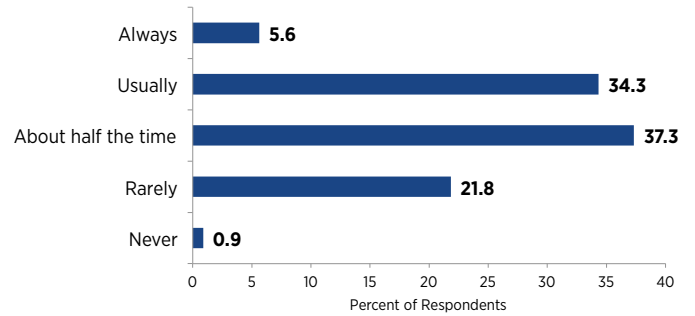


FIGURE 16

Frequency of Small Business Loans Backed by Other Collateral/Guarantees

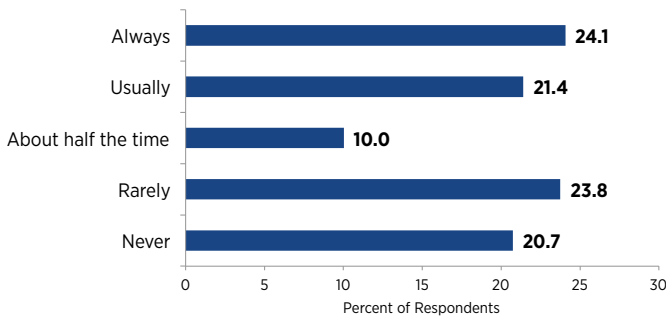
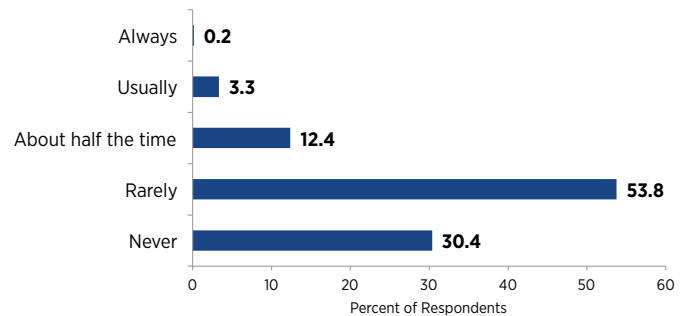


FIGURE 17

Frequency of Small Business Loans Backed by the Small Business Administration



are relatively uncommon, with nearly 85 percent of respondents stating that they never or rarely extended these types of loans (Figure 17). Less than four percent of bankers said that their small business loans were always or usually backed by the SBA.

Close relationships between community banks and small businesses often present opportunities and incentives for collaboration in other areas.⁷ In this regard, 95 percent of respondents reported that they always or usually provide deposit services to small business borrowers (Figure 18). Advice on long-term strategy and general management advice was provided at least “about half the time” by nearly 50 percent of respondents (Figure 19). And nearly 60 percent of respondents said they provide cash management services at least “about half the time” (Figure 20). The latter may reflect a capacity for banks that offer cash management services to “increase the profitable products to profitable customers.”⁸

Other, perhaps less tangible, support services were infrequently offered. For instance,

NOTE: Results in Figures 14-17 are for loans originated in 2016.

more than 75 percent of respondents said that they never or rarely provided connections to customers or suppliers (Figure 21). Similarly, more than 80 percent of bankers never or rarely provided advice on product development (Figure 22), while more than 60 percent indicated the same for management succession planning (Figure 23), operations advice (Figure 24) and wealth management advice (Figure 25). General management advice, on the other hand, was more commonly offered (Figure 26).

The abovementioned findings suggest that the high-touch service provided by community bankers often is applied holistically rather than to specific product areas only. This interpretation is reflected in the comments of surveyed bankers, who described their comparative advantages using phrases such as “connectivity,” “the ability to respond in a timely manner to customer requests” and “being a part of communities.”

Volume and Growth of Small Business Lending

Although small business loans may be the lifeblood of community banks, they do not dominate their portfolios. As seen in Table 4, these loans are only the third-largest category of loans by dollar volume among those listed, and they comprise just 17 percent of the total loan portfolios of surveyed banks.

Small business loans for surveyed banks increased by six percent in 2016, the slowest rate of increase of any category of loan,

FIGURE 18
Frequency of Providing Deposit Services to Small Business Borrowers

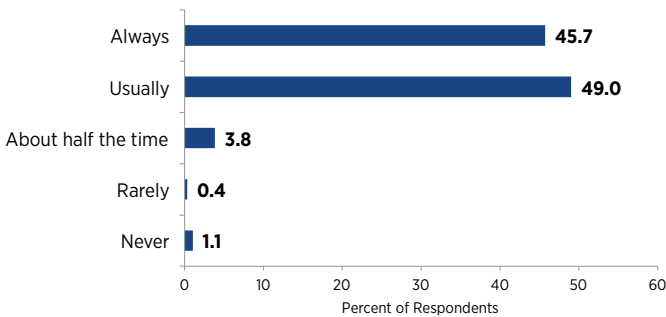


FIGURE 19
Frequency of Providing Long-term Strategy Advice to Small Business Borrowers

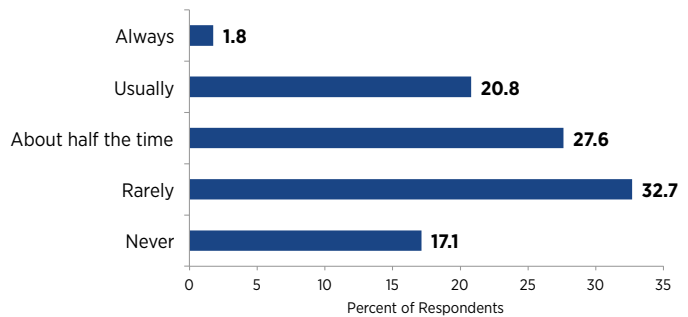


FIGURE 20
Frequency of Providing Cash Management to Small Business Borrowers

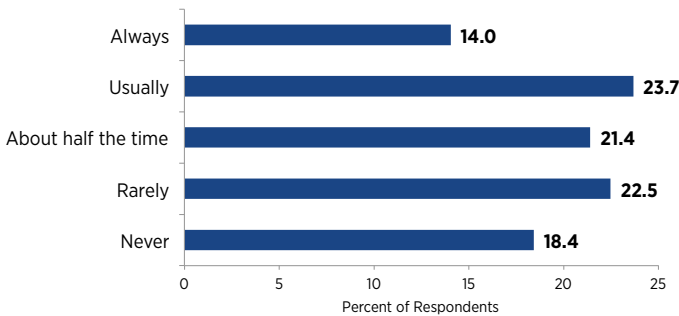


FIGURE 21
Frequency of Connecting Small Business Borrowers to Other Customers/Suppliers

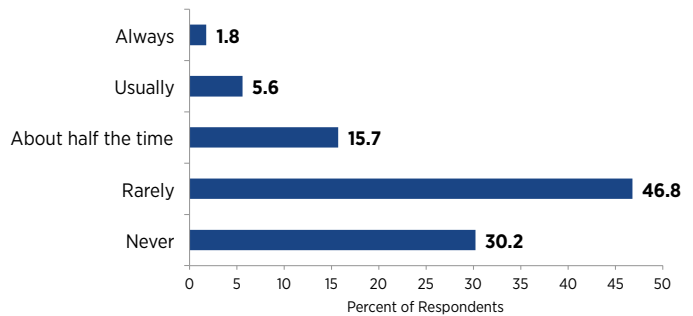


FIGURE 22
Frequency of Providing Product Development Advice to Small Business Borrowers

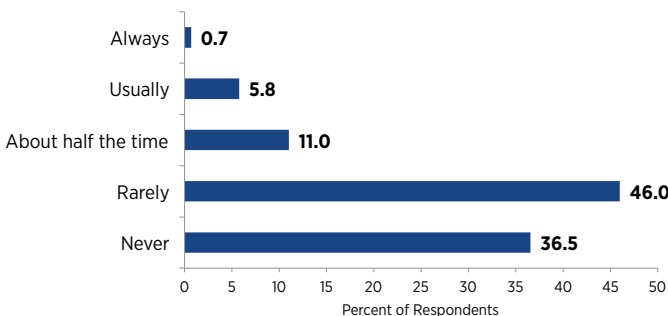


FIGURE 23
Frequency of Providing Succession Planning Advice to Small Business Borrowers

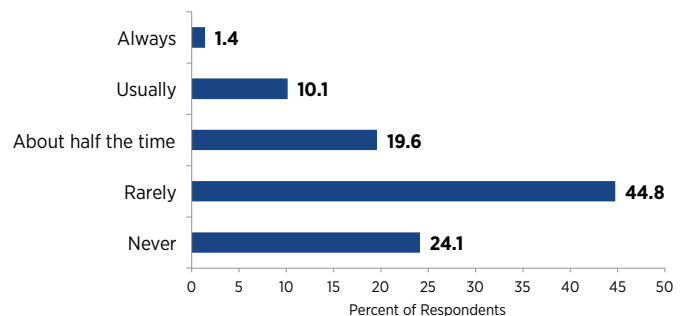


FIGURE 24

Frequency of Providing Operations Advice to Small Business Borrowers

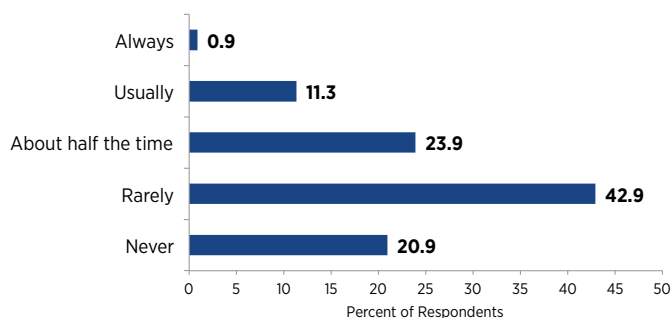


FIGURE 25

Frequency of Providing Wealth Management Advice to Small Business Borrowers

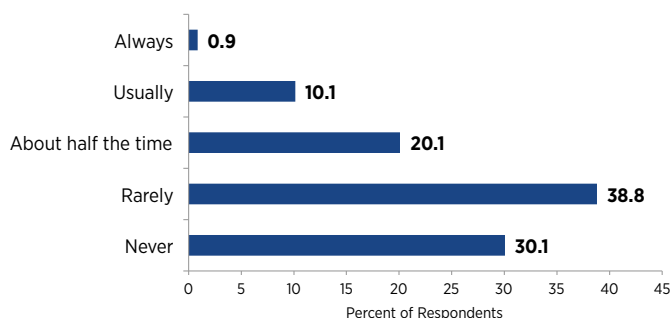
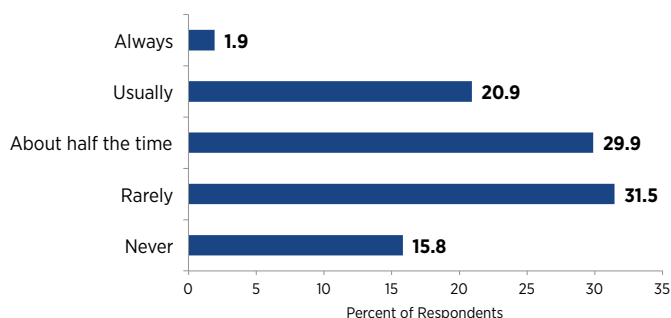


FIGURE 26

Frequency of Providing Other General Management Advice to Small Business Borrowers



aside from auto loans, that are listed in the table. This increase, modest as it may be, contrasts with a decline in small business lending among all community banks, as indicated in Table 5. The table shows the number of small business loans made, the dollar volume of small business loans and the ratio of small business loans to total loans made by both community banks (with less than \$10 billion in assets) and other banks (with more than \$10 billion in assets). The values are industry-wide totals calculated at the end of each calendar year.

These numbers suggest that community banks have lost some ground to bigger banks in small business lending over the past three years. Loans by banks with assets of less than \$10 billion declined by two percent, to \$269 billion, in 2016; meanwhile, the same loans by banks with assets of more than \$10 billion increased by five percent, to \$284 billion.

The average size of small business loans made by community banks in 2016 was \$95,000, while the average balance for larger banks was just \$16,000. This gap has widened in each of the past two years, perhaps reflecting the growing advantage of larger banks in relying on economies of scale to process smaller loans using credit scores.

Loans Other than Small Business

Results from the survey on lending activities apart from small business loans are presented in Figure 27. Lending products are arrayed by: 1) loans currently offered with plans for continuation; 2) loans currently offered that are expected to be

TABLE 4

Loan Portfolios of Surveyed Banks

	Dollar Volume (in \$ billions)	Percent of Total Loans	Growth in 2016
Small Business	\$35.5	17%	6%
Commercial Real Estate	\$62.7	29%	17%
Construction Component	\$16.9	8%	20%
1-4 Family Residential Mortgages	\$52.0	25%	10%
Home Equity Lines of Credit	\$7.9	4%	10%
Consumer	\$7.8	4%	7%
Credit Card Component	\$0.2	0%	7%
Automobile Component	\$3.7	4%	2%

TABLE 5

Loans to Small Businesses

	Less than \$10 Billion in Assets			More than \$10 Billion in Assets		
	No. of Loans	Amount	Percent of Total Loans	No. of Loans	Amount	Percent of Total Loans
2016	2.83	\$269	15.9%	17.97	\$284	4.1%
2015	2.86	\$275	16.6%	15.48	\$270	4.2%
2014	2.82	\$275	17.5%	14.77	\$255	4.3%

NOTE: Numbers of loans are expressed in millions and dollar amounts are expressed in billions. Percentages are ratios of loans in a particular category to total loans.

curtailed; 3) loans that are not offered currently and are not expected to be offered; and 4) loans that are expected to be offered that are not offered currently. This breakdown provides insight into both the current and anticipated lending strategies of community banks.

Construction Loans

Construction loans were named by 94 percent of respondent banks as a product that they currently offer and plan to offer in the future, which is slightly higher than the 92 percent reported in last year's survey.⁹ The dollar amount of loans held by these banks was nearly \$17 billion at the end of 2016 (Table 4). This amount represented eight percent of total loans, slightly higher than what was reported in the prior year.

Slightly more than one percent of banks said that they do not currently offer construction loans but plan to do so in the future. Although this percentage is low in an absolute sense, it is interesting insofar as it represents more than 30 percent of all banks that do not offer construction loans—that is, even at a point well into the economic cycle, these banks still plan to enter the market. Reasons cited by

respondents included market expansion (33 percent) and profitability (44 percent).

Conversely, one percent of banks that currently offer construction loans stated that they plan to exit or substantially limit their involvement in this business. Many respondents attributed this decision to a lack of profitability (33 percent). Thus, some bankers conveyed plans to enter the market given perceived profit opportunities, while others reported exiting due to an inability to capture them.

Regulatory costs matched profitability as a factor in planned exits. One banker noted, "We had a raw land loan for \$50,000 the other day and there were 148 pieces of paper related to this loan. That, my friends, is not cost-effective for us."

Growth in construction lending increased last year by 20 percent (Table 4), which matched the previous year's result. A slightly lower increase of 17 percent was recorded in the more inclusive category of commercial real estate lending. These rapid rates of growth coincided with a warning issued by bank regulators in December 2015 with respect to "prudent risk management practices for commercial real estate lending activity through economic cycles."¹⁰ The warning

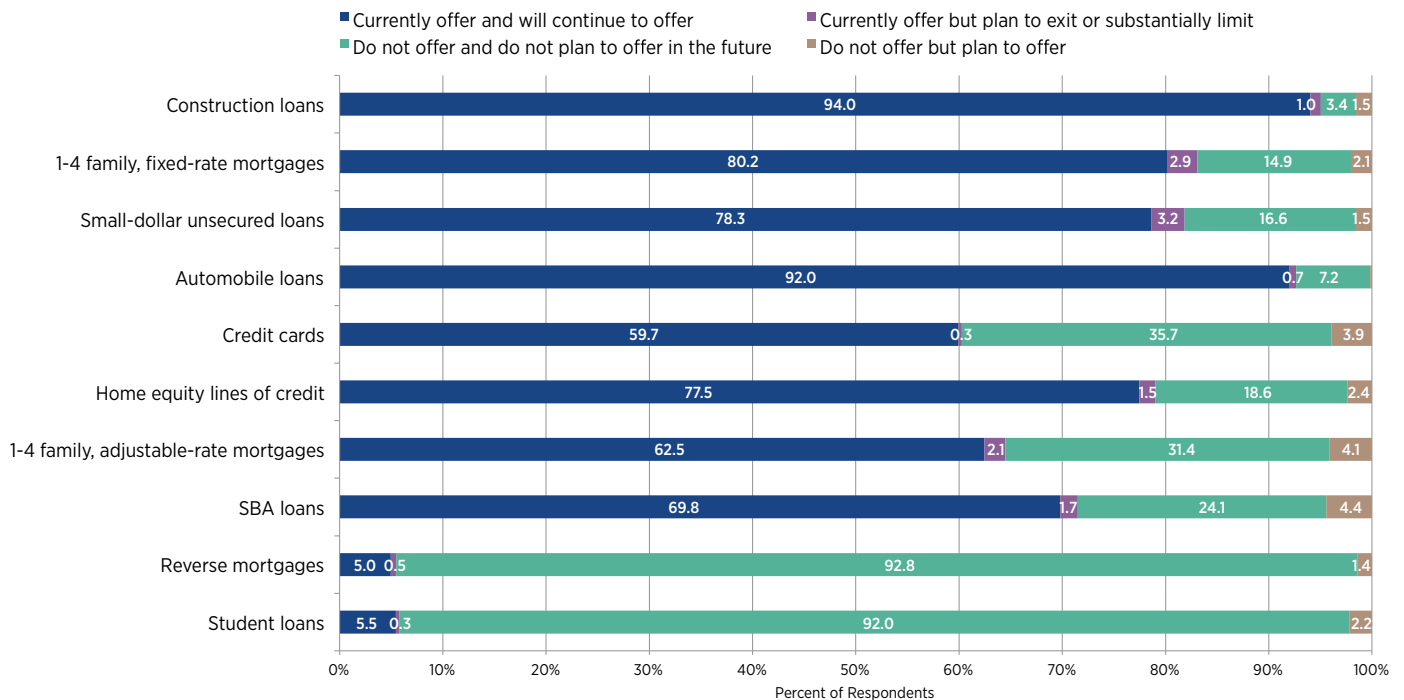
was said to result in "some banks taking their foot off the gas pedal for apartment construction loans."¹¹ A survey of loan officers earlier this year similarly indicated a tightening of credit policies associated with a less favorable outlook for commercial real estate prices, reduced tolerance for risk and supervisory actions.¹²

Mortgage Loans

Mortgage lending remains a prominent activity among surveyed banks, with 1-4 family, fixed-rate lending named by more than 80 percent of respondents as a product currently offered that would continue to be offered (Figure 27). This is higher than the 76 percent reported last year and contrasts, to some extent, with the five percent of banks that last year planned to exit from or substantially limit this activity.

A similar finding was observed this year, as three percent of banks planned to curtail 1-4 family, fixed-rate mortgage lending. Mortgage regulations were named by 65 percent of respondents as the reason for planned withdrawals from the market. Of particular note were lending rules for Qualified Mortgages (QM) that were implemented in 2014 by the Consumer Financial Protection Bureau (CFPB).¹³

FIGURE 27
Lending Products



One surveyed banker said, “We are wasting too much time on mortgage loans, and there is too much risk associated with these loans for us to stay in this market.”

Respondents emphasized other concerns in mortgage lending, notably with the TILA-RESPA Integrated Disclosure Rule, referred to as TRID, under the Truth in Lending and Real Estate Settlement Procedures acts (Figure 28). Increased regulatory liability was cited as a challenge by 23 percent of respondents. And more than 40 percent of respondents cited “a slower pace of business” or “delayed closings,” which is consistent with the comments of one banker who described problems in “growing our mortgage business, since many local banks are frustrated with the difficulty of processing mortgage loans.”

Non-QM mortgage lending activity, however, appears relatively stable despite regulatory tumult (Table 6). Withdrawals from this market were modest, as the percentage of respondents who stated that zero percent of their lending portfolio was in non-QM mortgages increased to about 27 percent in 2016 from 24 percent in 2014. Those who stated that more than 80 percent of their loan portfolio was in non-QM mortgages decreased to less than six percent from seven percent during this same period.

Similarly, mortgages among surveyed banks increased last year by 10 percent to a level that accounted for 25 percent of total lending (Table 4). Such growth is consistent with the recognition of an expanding market and a desire to match the competition as rationales for banks to enter the market. It also may be due to industry consolidation insofar as one banker identified “expanding mortgage opportunities” attributable to mergers and acquisitions among competitors.

Other Lending

Small-dollar unsecured consumer loans were offered, with plans for continuation, by 78 percent of community banks (Figure 27). Persistence at this level is doubtful, however, since bankers identified these loans as those they are most likely to exit or substantially limit. Unprofitability, regulatory costs and market contraction were

FIGURE 28

Greatest Challenge from TILA-RESPA Integrated Disclosure Rule (TRID)

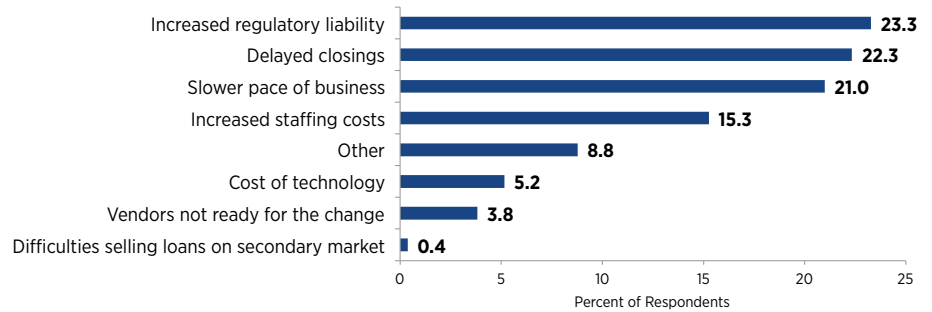


TABLE 6

Percentage of Non-Qualified Mortgages Made by Community Banks

	2016	2015	2014
N/A (no mortgages in portfolio)	5.3%	3.7%	8.0%
0%	26.5%	25.7%	23.8%
>0 to 20%	45.5%	46.4%	44.8%
>20 to 40%	8.5%	7.6%	9.5%
>40 to 60%	3.6%	4.8%	4.6%
>60 to 80%	4.6%	2.8%	2.2%
>80%	5.6%	8.5%	7.0%

cited as common factors in these decisions; concerns also may stem from expected heightened competition from fintech companies. The small fraction of banks planning to enter this market (1.5 percent) mostly said they were motivated by market expansion.

Automobile loans were offered by 92 percent of surveyed banks (Figure 27), which is slightly higher than what was reported last year. Saturation is suggested by the mere handful of banks that plan to discontinue or introduce lending in this category. Lack of profitability was the most commonly cited factor in planned exits, perhaps reflecting a pullback in auto lending amid concerns about overheated competition and used-car values.¹⁴ This is confirmed by growth in automobile lending last year of just two percent, the slowest pace of any reported lending category (Table 4).

Credit cards were offered by 60 percent of surveyed banks (Figure 27). This is a sharp increase from the 51 percent identified in the prior year and corresponds with the high percentage of banks in the earlier

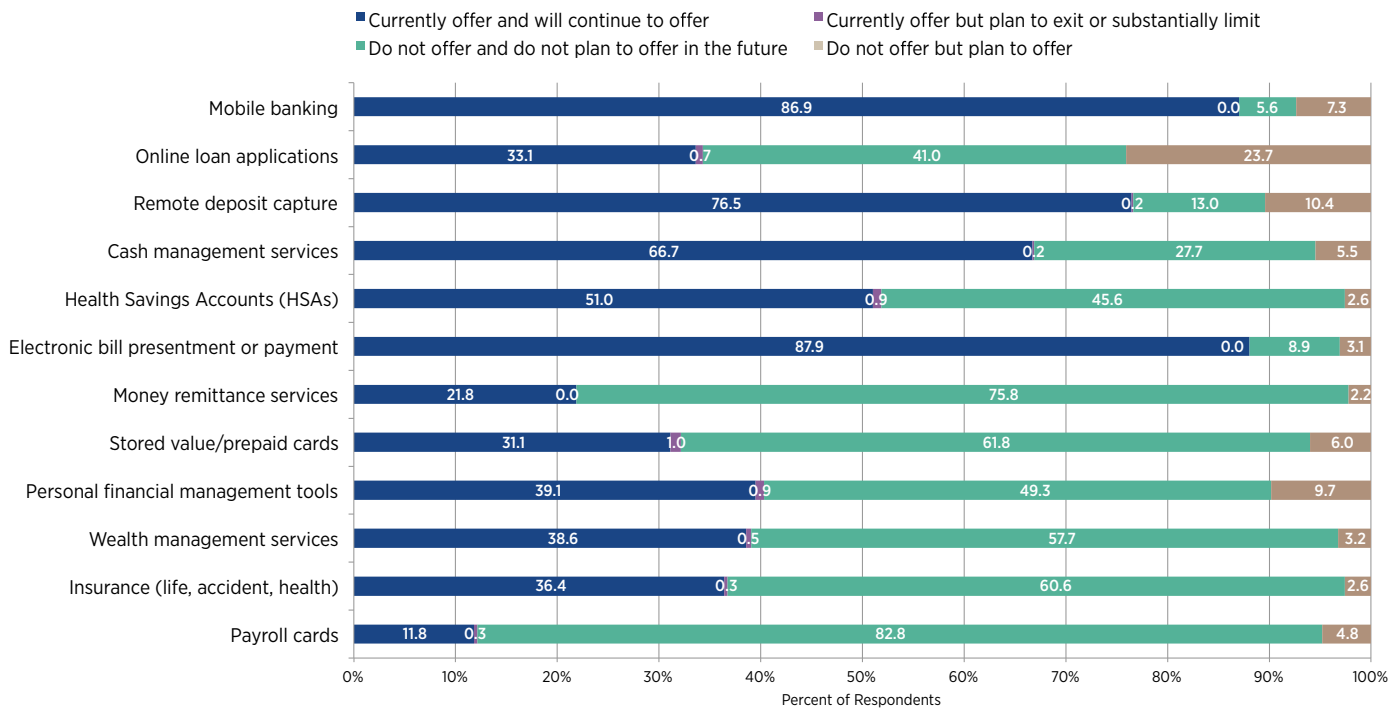
survey that did not yet offer credit cards but planned to do so. In this year’s survey, almost four percent of banks reported plans to offer credit cards in the future, while less than one percent intended to curtail them. The former, which many respondents said was driven by market expansion, profit potential and a desire to match the competition, may point to the potential advantages that even small banks see accruing with card issuance.¹⁵ The latter was attributed to intensifying competition and profitability concerns.

The widespread offering of credit cards by community banks contrasts with the relatively modest dollar amount of lending associated with them. In this regard, credit card lending accounted for less than one percent of the total loan portfolios of community banks (Table 4). In comparison, the same ratio approached 10 percent for banks with total assets of \$1 billion or more.¹⁶

The more inclusive category of consumer loans constituted four percent of the total loan portfolios of surveyed banks (Table 4). These loans grew by seven percent in 2016, which some bankers may consider

FIGURE 29

Nonlending Services



significant in view of the pressures exerted by online competitors.

Home equity lines of credit (HELOCs) and adjustable-rate mortgages (ARMs) also were important components of currently offered products, at nearly 78 percent and 63 percent, respectively (Figure 27). Both percentages were higher than those reported in last year's survey. Bankers planning to add these products noted that they were motivated by an expanding market and, to a lesser extent, a desire to meet the competition.

These latter two lending categories were not heavily represented in portfolios, however. HELOCs, for instance, constituted only about four percent of the total loan portfolios of surveyed banks (Table 4). Regulation seemed to play a role here, as regulatory costs were blamed for planned withdrawals from HELOCs (55 percent) and from ARMs (67 percent). As one banker said, "NASA can land a rover on Mars with a higher degree of error than I'm allowed in my HELOC portfolio."

Lending under the SBA was named by 70 percent of bankers as a product that

they currently offer and plan to continue to offer (Figure 27).¹⁷ This percentage is slightly higher than that reported last year, which is consistent with its identification at that time as the lending activity for which planned offerings were highest. Such plans persist this year as well, as less than two percent of respondents planned to curtail their SBA activity, while four percent planned to enter the market. The latter group was motivated by market expansion and a desire to meet the competition.

Very few respondent banks indicated that they offered reverse mortgages or student loans. Regarding the latter, it is interesting to note that in last year's survey nearly seven percent of bankers identified student loans as a lending activity that they planned to offer, which was the highest of any category. Bankers intending to offer student loans, as well as reverse mortgages, cited market expansion and profit potential. But sometimes only ambivalently:

"We are increasing the availability of student loans," one banker said. "However, in the 15 years I've been here, we've done one. I'm not holding my breath."

Nonlending Activities or Services

Findings from the survey on nonlending activities are presented in Figure 29. Results are arrayed, once again, by category: 1) services currently offered with plans for continuation; 2) services currently offered that are expected to be curtailed; 3) services that are not offered currently and are not expected to be offered; and 4) services that are expected to be offered that are not offered currently.

Mobile banking services—where smartphones or other cellular devices are used to perform online banking tasks, including paying bills, monitoring account balances and transferring funds—were offered by 87 percent of surveyed banks. This percentage is higher than the 81 percent recorded a year earlier and suggests that plans back then of about 13 percent of banks to introduce mobile banking services materialized.

This year, more than seven percent of surveyed bankers said that they planned to introduce these services in the future, while none planned to exit or substantially limit these services. The overwhelming reason cited by respondents for offering

these services was a desire to match the competition. This response is not particularly surprising; in one digital banking survey, respondents said that good online banking services were the top reason for staying with a bank—ahead of locations and low fees.¹⁸

More than 33 percent of surveyed banks offered online loan applications, which is only slightly higher than the level reported last year. This is somewhat surprising, since last year more than 28 percent of bankers that didn't offer these applications said that they intended to do so. A similar level of intended expansion is evident in this year's survey, with about 24 percent of banks indicating future rollouts. The most prominent reason for offering these services was a desire to match the competition in an expanding market. In this regard, banks have a long way to go: Just 31 percent of retail customers and 17 percent of credit card customers currently use mobile apps, according to one recent report.¹⁹

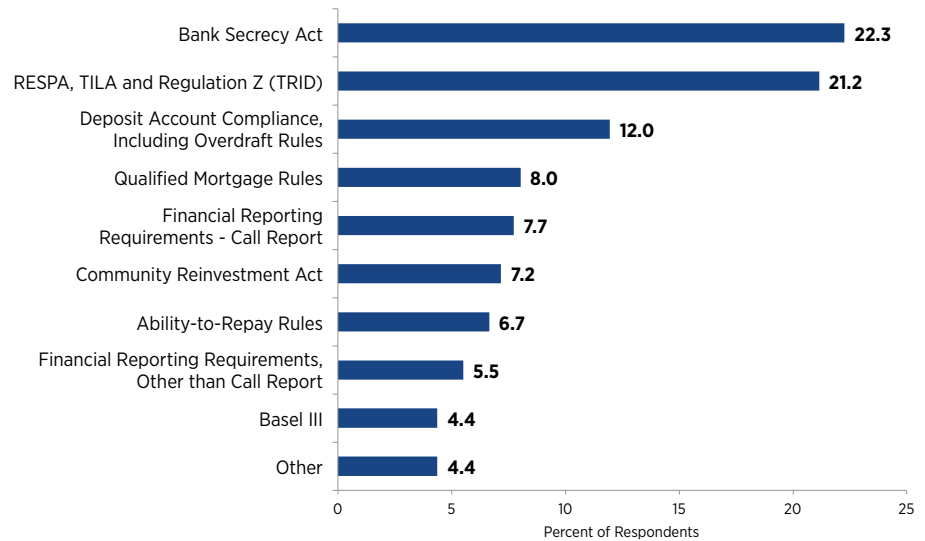
The apparently stalled level of interest in online lending activity may reflect operational challenges, as profitability concerns were named by 33 percent of respondent banks as a factor in decisions to exit. "We would like to be able to expand our customer base, in part by utilizing internet/mobile banking technologies," one banker said. "We are trying to find a technology that we can afford."

Remote deposit capture, which allows a customer to scan checks remotely and transmit the check image for deposit, was named by 77 percent of bankers as an ongoing activity. This was higher than what was reported last year (71 percent) and could rise again next year insofar as more than 10 percent of banks that did not offer this service planned to do so. A desire to match the competition was the most often cited rationale.

Cash management services were offered by 67 percent of surveyed banks. Although very few banks planned to exit these services—which relate to the collection, handling and use of cash by business customers—those that did cited intensifying competition. Those planning to enter cited a desire to match the competition. Competitive concerns may be related to

FIGURE 30

Percentage of Compliance Costs Due to Specific Regulations



the description of community banks as "under-armed" in their cash management offerings.²⁰

Health savings accounts (HSAs) are accounts used in conjunction with health insurance policies to save money, tax-free, for medical expenses. More than half of respondent banks offered HSAs with plans for continuation, up from 45 percent reported in last year's survey. This trend may not persist, however, as planned introductions were low relative to planned discontinuations. Planned discontinuations were attributed to profitability concerns (40 percent), while planned introductions were attributed to market expansion (53 percent).

Stability in current offerings was more evident in other areas, including electronic bill payment (88 percent this year and last year), money remittance services (22 percent this year versus 19 percent last year) and stored value/prepaid cards (31 percent versus 32 percent). Among these activities, stored value/prepaid cards ranked highest with respect to plans for introduction as well as plans for discontinuation, with planned discontinuations attributed to increases in regulatory costs and profitability concerns. A primary rationale for planned offerings of all three services was a desire to meet the competition.

Personal financial management, insurance and wealth management all were

offered by nearly 40 percent of banks, exceeding last year's percentages. Wealth management, in particular, was said by one banker to have "a lot of potential to expand, especially with an aging population." This was borne out by the prominent role of market expansion as a rationale for its introduction, cited by 47 percent of respondents, as well as for the introduction of financial management services (30 percent) and insurance offerings (20 percent). Few banks offered payroll cards, which are used by employees without checking accounts, but many more said that they intended to introduce them in the future.

Overall, offerings were up this year compared with last year in every lending and nonlending activity except for money remittance services. This trend appears to suggest a more optimistic attitude among bankers: "We feel that we are poised for growth in our market," one banker said. "While other banks struggle with regulatory burdens and lose focus, we will have the opportunity to grow and expand our services."

Regulatory Compliance

Community bankers remain frustrated by regulations that they say unduly constrain how they go about their business. One banker noted that regulations "have come at such a pace that we are drowning ... in what most of us believe is nonsense."

Another lamented that “the community bank is dead with regulatory interference.”

But a potential turn of the tide, which was observed in last year’s survey, appears underway. Burden has been reduced in some areas under the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA).²¹ And there was the election of a Congress that has pledged to cut regulations. This latter development seems to have shifted the focus of community bankers from “grappling with new regulatory pressures” to “discussing what potential reform might look like.”²²

One banker, in a representative comment, spoke of “listening to the Trump administration wanting to scale back the compliance burden in the financial industry,” which the banker said “could not happen soon enough.” Another banker highlighted the discussions taking place on regulatory reform, but admitted to being “doubtful” that reform would be meaningful: “All of this said, if regulatory reform can simply slow the growth and rate of change in existing regulation, it will be a win.”

A contraction in the competitive landscape due to regulatory burden was seen as an opportunity among some bankers. One banker noted, “As other community banks throw in the towel and sell or merge due to regulatory burden, our bank may be able to capitalize on being one of the last remaining local institutions.”

Costs of Compliance

As part of this year’s survey, bankers were asked to identify compliance costs across five categories: personnel, data processing, legal, accounting and auditing, and consulting and advisory. The goal was to illustrate regulatory burden relative to various categories of operating expenses. This information is presented in Table 7.

As the table shows, regulatory compliance for surveyed banks in 2016 accounted for roughly 12 percent of personnel expenses, 18 percent of data-processing expenses, 23 percent of legal expenses, 42 percent of accounting and auditing expenses, and 45 percent of consulting expenses. These percentages all are higher than those reported in our previous survey.

Another way to look at costs is from the perspective of changes over time. Take,

for example, personnel expenses, which represent the largest dollar expenditure. Mean compliance expenses in this category, expressed as a share of total category expenses, increased by eight percent both last year and the year before, while median expenses increased two percent last year, versus 29 percent in the previous year. (Previous-year comparisons are based on information from prior surveys.) Similar relationships are evident in analyses of the other smaller categories of compliance expenses.

It is tempting to conclude that rates of increase in relative compliance expenses are moderating. Such a conclusion is tempered, however, by idiosyncrasies in our survey methodology—that is, with the quality of the data, how they are reported, which banks report them and how they are measured (e.g., medians versus means). But it seems reasonable to infer from the data presented that the rates of increase in regulatory costs are far from exploding.

In Table 8, we apply the compliance cost percentages observed in Table 7 to data on the community banking industry obtained

from Call Reports. Implied dollar expenses for 2016 across listed categories, respectively, are \$4.2 billion, \$532 million, \$109 million, \$199 million and \$327 million.²³ The total dollar amount for compliance costs under this estimation would be \$5.4 billion, representing 24 percent of community bank net income.²⁴

To supplement our analysis of the levels of compliance expenses, we sought to identify the specific regulations to which those expenses could be attributed (Figure 30). The most costly regulations were associated with the Bank Secrecy Act (BSA), which accounted for 22 percent of compliance expenses of respondent banks. The BSA requires banks to report cash transactions of more than \$10,000 and suspicious activities that might indicate possible money laundering or fraud. These reporting requirements often force banks to hire additional personnel to handle the required reporting volume. BSA-related expenses also include costs for independent reviews of a bank’s BSA compliance program by consultants or external auditors.

TABLE 7
Compliance Costs as a Percentage of Total Expenses by Category

	2016	2015	2014
Personnel (Salary and Benefits)	12.3% 7.7%	11.4% 7.5%	10.6% 5.8%
Data Processing	17.8% 11.4%	17.6% 12.9%	16.2% 10.0%
Legal	23.0% 14.7%	20.7% 12.8%	20.5% 10.6%
Accounting and Auditing	41.7% 35.1%	41.5% 35.3%	38.5% 30.6%
Consulting and Advisory	44.6% 39.4%	42.6% 34.3%	47.5% 40.0%

NOTE: The percentages are **means** (first row) and **medians** (second row) of ratios of compliance costs to total expenses within each expense category.

TABLE 8
Implied Dollar Amounts of Regulatory Costs, All Community Banks (in \$ millions)

	2016	2015	2014
Personnel (Salary and Benefits)	\$4,236	\$3,801	\$3,350
Data Processing	\$532	\$507	\$440
Legal	\$109	\$112	\$128
Accounting and Auditing	\$199	\$223	\$198
Consulting and Advisory	\$327	\$325	\$378
Total	\$5,403	\$4,968	\$4,494

TRID was the next costliest regulatory requirement. (See sidebar below.) Other expenses were more evenly distributed. Costs associated with deposit account compliance were 12 percent of total compliance expenses, while costs associated with Basel III—a global framework for regulating bank capital adequacy—came in at four percent. The breadth of these costs is concerning to bankers, one of whom was challenged by “regulatory overkill, including, but not limited to, fair lending, BSA, HMDA, TRID and every other thing that CFPB can come up with.”

Market Competition

Community bankers have been preoccupied with the influence of performance on consolidation in seeking to understand why so many banks have been lost in recent years. In previous surveys, many of them expressed worries that their banks could be next.

This year, a subtle shift has emerged insofar as some bankers are anticipating the influence of consolidation on performance. In this regard, one banker said that consolidation creates “a void where individuals and small business will

appreciate the services we can provide as a community bank.”

It is from this perspective that we analyze the results of our survey on questions concerning market structure and, more specifically, the competitive pressures facing community banks and how they are responding to mergers and acquisitions.

Sources of Competition: Lending Products

Small Business Loans

The battle for small business borrowers is being fought, almost exclusively, by community banks with other banks. Survey respondents rarely mentioned credit unions, fintech firms, the Farm Credit System or other nondepository intermediaries as the single greatest source of current competitive pressure (Figure 31). Small community banks were named as the toughest competitor by more than half of respondents, and midsize community banks were named as the toughest competitor by more than 26 percent of respondents.

The current competitive landscape, however, may not persist. Although community banks are still expected to dominate, survey respondents see greater competition coming from credit unions and fintech firms (Figure 32). Credit unions were named as the greatest source of future competition by 10 percent of respondents (versus three percent for current competition), while fintech firms were named by seven percent of respondents as the biggest source of future competition (versus less than one percent for current competition).

An interesting change from last year’s survey is a retrenchment by regional banks, which were named as the dominant competitor by more than 16 percent of respondents last year but only about half that level this year. In this regard, regional banks were described as being “stuck in the middle” between bigger banks, with easy self-service options, and smaller banks, which have bolstered excellence in customer service with lower fees and improvements in technological services.²⁸ This is significant when competing across a dynamic environment in which 25 percent of fast-growing small businesses said they expected to switch banks within a year.²⁹

Compliance Costs under the TILA-RESPA Integrated Disclosure Rule (TRID)

Prior to the passage of Dodd-Frank, federal law required that consumers applying for a mortgage be provided with two separate forms, at two separate points in time, disclosing information on the mortgage’s features, costs and risks. Consumers received the first form when applying for a mortgage and the second form shortly before closing on the loan. These forms were developed under the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act (RESPA).

The information on these forms was overlapping, and the language was inconsistent. Consumers were reportedly confused.²⁵ In response, the forms were combined under the TILA-RESPA Integrated Disclosure Rule (TRID), which was implemented on Oct. 1, 2015.

Although TRID was expected to reduce the burden on lenders when preparing the forms, bankers felt otherwise. Community bankers, in particular, worried about expenses paid to third-party vendors for software updates and systems upgrades.²⁶ Many bankers also questioned the readiness of vendors to provide the necessary upgrades and expressed concern about costs for training employees to use the new systems.

In this year’s survey, more than 20 percent of compliance-related expenses were attributed to TRID (Figure 30). Costs for staffing and technology were identified as the most important impacts of TRID by 15 percent and five percent of respondents, respectively (Figure 28). And nearly four percent of bankers cited unprepared vendors as their top concern. TRID-related expenses also represented significant challenges for banks in changing management processes to accommodate increasing operational, compliance and other risks.²⁷

“Customers want their money, not seven pages of disclosures about things they don’t understand,” one surveyed banker said. “The process is being made too difficult. It is no surprise that small banks are selling out to larger institutions that have the economies of scale to keep up with ever-changing rules.”

The foregoing complaint, however, may have embedded seeds of optimism—i.e., what if TRID expenses reflect one-time costs of establishing and developing efficiencies in operating software systems necessary to process the new disclosure forms? These costs are likely to have been concentrated in the periods leading up to and immediately following TRID’s implementation in late 2015. From this perspective, our estimate of \$5.4 billion in overall compliance costs for the community banking industry (Table 8) may be inflated. Assuming that more than 20 percent of compliance costs are attributable to TRID, and that a significant component of those costs are temporary, upward pressure on expenses may moderate in the future.

FIGURE 31

Greatest Source of Current Competition: Small Business Loans

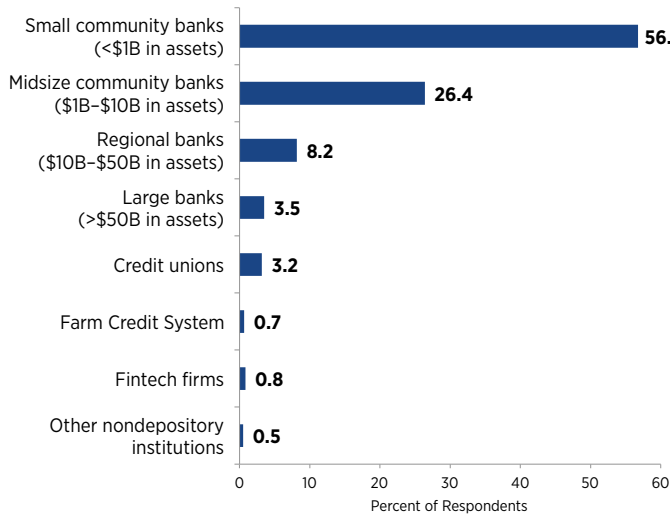


FIGURE 32

Greatest Source of Future Competition: Small Business Loans

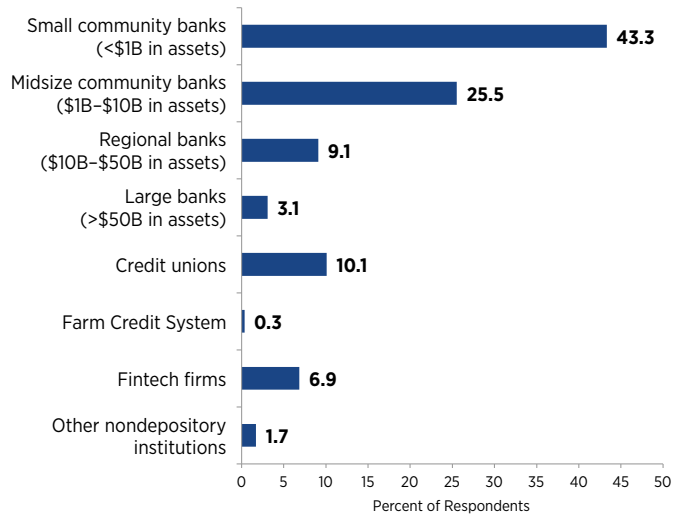


FIGURE 33

How often did competition from other lenders cause you to ease lending terms on small business loans by lowering interest rates?

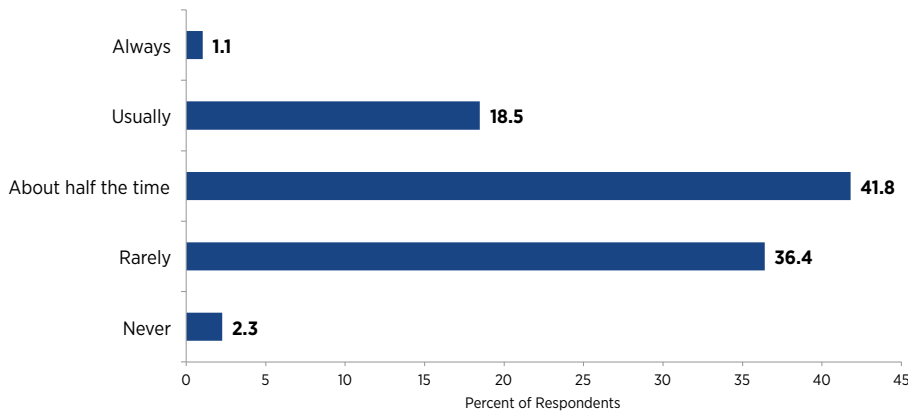
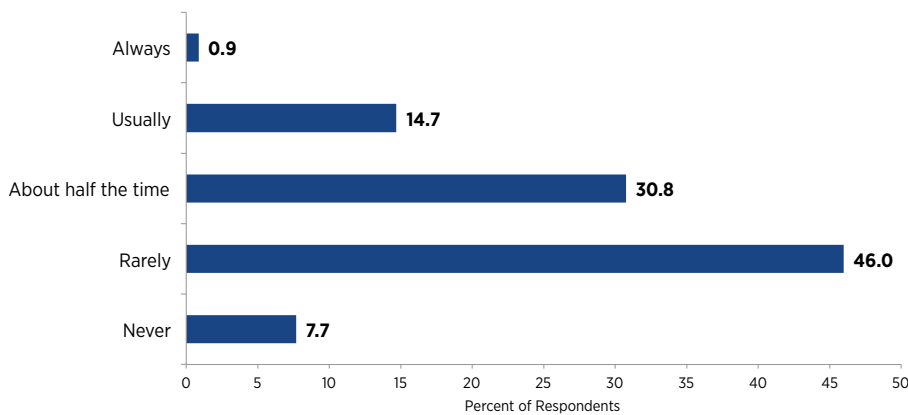


FIGURE 34

How often did competition from other lenders cause you to ease lending terms on small business loans by lowering fees?



As such, community bankers appear wary when it comes to competing for small business loans. One community banker noted that responding to “competition for good loans” was a challenge, while another expressed concern with “irrational loan pricing and structuring from regional competitors.” Both comments raise an interesting question: How do community banks respond to competitive pressure for small business loans?

With respect to pricing, 61 percent of respondents said that competition from other lenders has caused them to lower interest rates on small business loans more than half the time (Figure 33). Less than three percent of bankers said that they “never” lower rates in response to competitive pressure. Both findings are consistent with a survey of loan officers indicating that more aggressive competition in the first quarter of 2017 contributed to narrower spreads on commercial and industrial loans.³⁰

Community banks also respond to competitive pressure for small business loans by lowering fees, albeit to a lesser extent than was observed with respect to interest rates (Figure 34). About 46 percent of respondents said that competition from other lenders caused them to lower fees on small business loans at least half the time.

FIGURE 35

How often did competition from other lenders cause you to ease lending terms on small business loans by reducing collateral requirements?

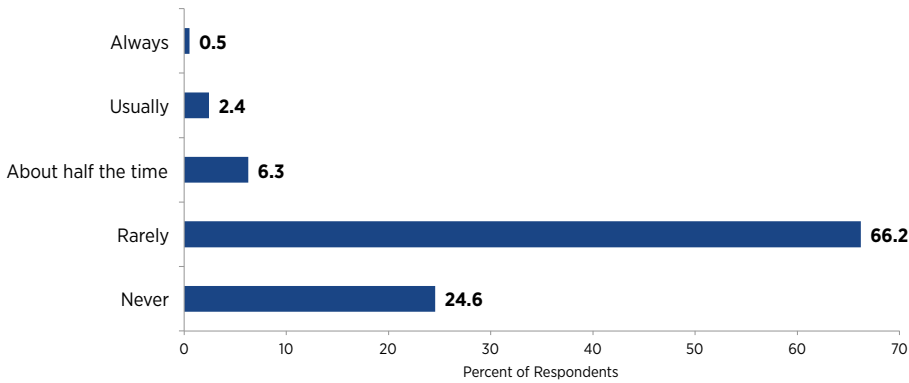
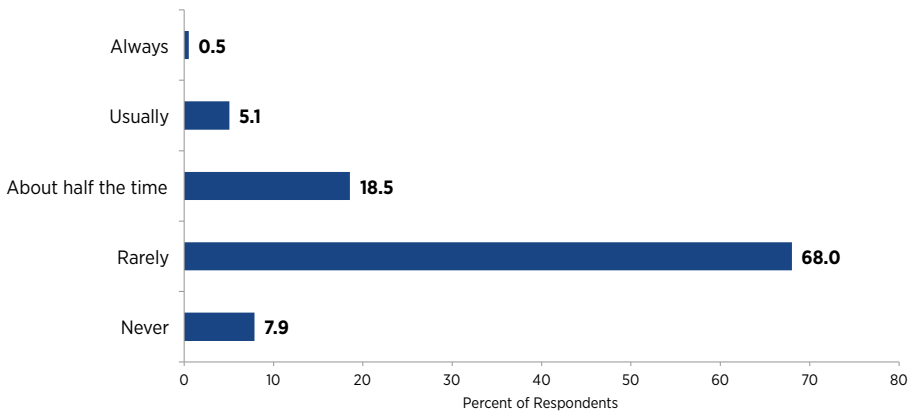


FIGURE 36

How often did competition from other lenders cause you to ease lending terms on small business loans by extending maturity?



More than half of the banks, on the other hand, reported that they rarely or never lower fees in response to competitive pressure. This may reflect, in part, the opinion of at least one banker that “more and more customers are telling us that pricing is not as important as it used to be.”

With respect to the structuring of small business loans, community banks appeared less motivated to make changes in response to competitive pressure. Less than 10 percent of bankers reduced collateral requirements at least half the time (Figure 35), and less than 25 percent of them extended maturity by the same frequency (Figure 36). Many community bankers also mentioned that competitive pressures sometimes force them to curtail requirements for personal guarantees.

Commercial Real Estate Loans

Small community banks similarly dominate the market for commercial real estate (CRE) loans, being named by nearly 42 percent of surveyed bankers as the toughest competitor (Figure 37). Midsize community banks were named by almost 37 percent of surveyed banks as the toughest competitor.

As was the case with small business loans, competition for commercial real estate loans from fintech firms and credit unions is expected to more than double in the

FIGURE 37

Greatest Source of Current Competition: CRE Loans

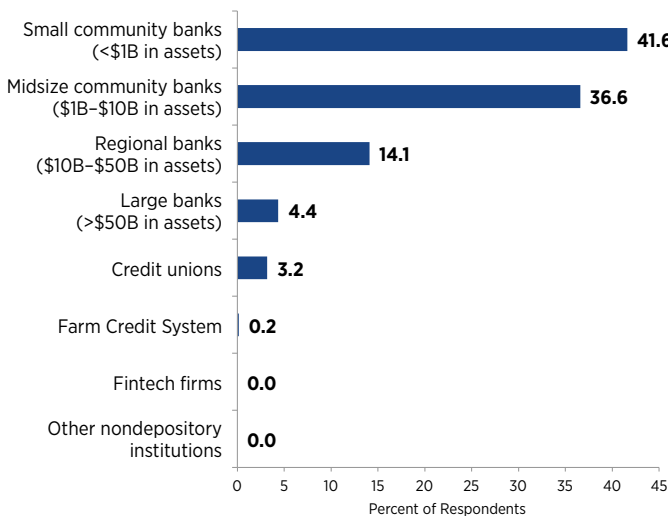
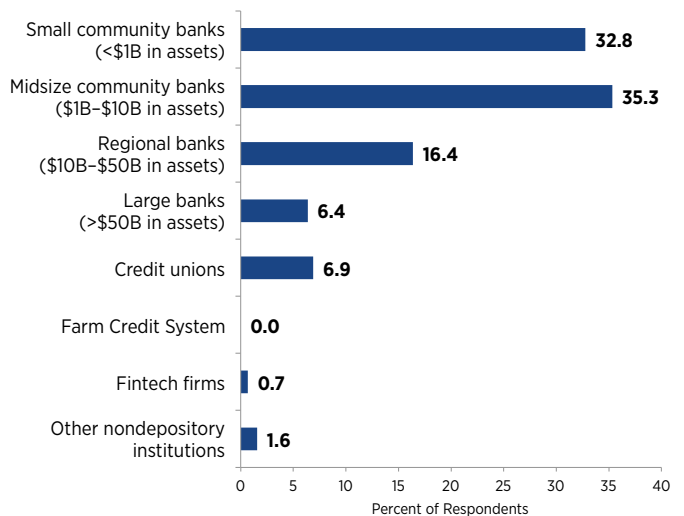


FIGURE 38

Greatest Source of Future Competition: CRE Loans



future (Figure 38). The latter group raised the ire of one respondent, who said that “credit unions are loaning to anyone and everyone without paying income taxes.”

Mortgage Loans

The market for mortgage loans appears more fragmented in terms of competition. Community banks, both small and midsize, were named as the single greatest source of current competitive pressure by slightly more than 40 percent of respondents (Figure 39). Other nondepository institutions, meanwhile, were named by

21 percent of respondents as their main competitor. This latter category includes Quicken Loans, an online mortgage lender, whose total closed loan portfolio of \$96 billion in 2016 made it the second-largest retail home mortgage lender.

Large banks and credit unions also play an important role in the mortgage market. They were named as the single greatest source of current competitive pressure by 13 percent and 10 percent of respondents, respectively. The role of fintech firms is currently modest, with just four percent of respondents identifying these companies as

their biggest competitor. Participation by the latter firms is expected to grow, however, with nearly 12 percent of respondents naming them as their toughest competitor in the future (Figure 40).

Agricultural Loans

The Farm Credit System dominates agricultural lending. This entity was named by about 65 percent of respondents as the single greatest source of competitive pressure (Figure 41). A similar percentage was reported in last year’s survey, as well as in this year’s survey, with respect to future

FIGURE 39

Greatest Source of Current Competition: Mortgage Loans

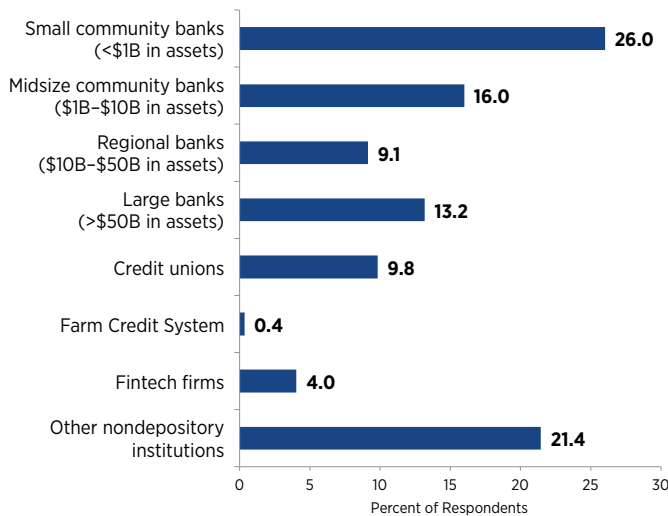


FIGURE 40

Greatest Source of Future Competition: Mortgage Loans

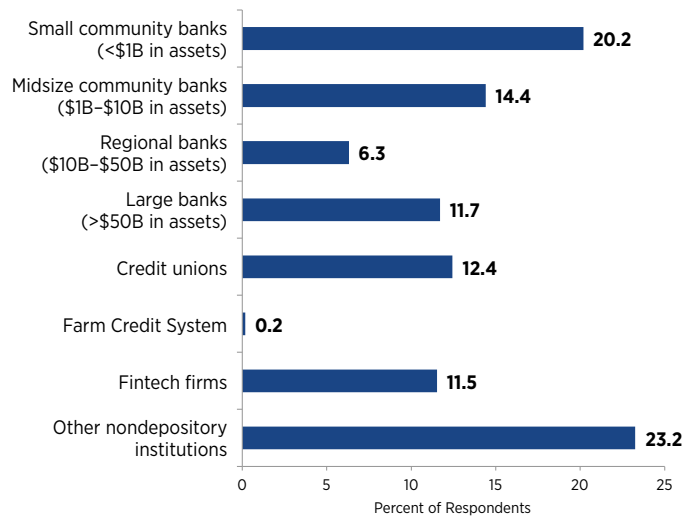


FIGURE 41

Greatest Source of Current Competition: Agricultural Loans

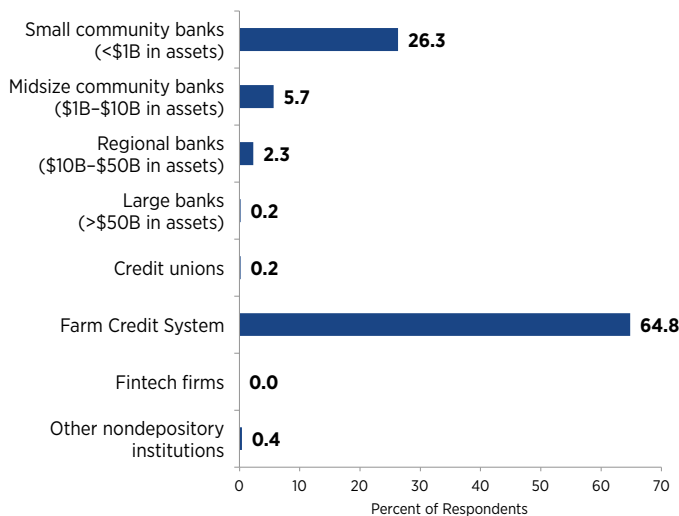
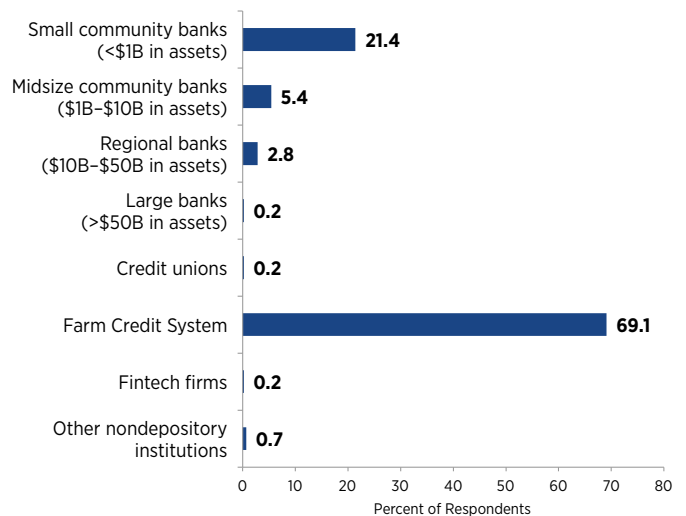


FIGURE 42

Greatest Source of Future Competition: Agricultural Loans



competition (Figure 42). One banker described the Farm Credit System as the “number one” concern: “Not only do they cherry-pick farmers, but they force pricing concessions using their full-faith guarantee to secure lower costs of funds. Plus, they are not expected to support their local economies through giving or payroll.”

Consumer Loans

As was the case last year, credit unions were named as the single greatest source of current competition for consumer loans

(Figure 43). The percentage of respondents who identified credit unions as their biggest competitor, however, dropped to 45 percent from 52 percent last year. A slight further decline to 44 percent is expected with respect to future competition (Figure 44). The difference may be attributed, in part, to fintech firms, which were named by two percent of respondents as the single greatest source of current competition but by 14 percent of respondents as the single greatest source of future competition.

Sources of Competition: Nonlending Activities

Deposits

Shifting from how money is invested on the asset side of balance sheets to how it is raised on the liability side, community banks, collectively, were named by nearly 60 percent of respondents as the single greatest source of competitive pressure for deposit accounts (Figure 45). This percentage decreases somewhat with respect to future competition, dipping to nearly 48 percent (Figure 46). Filling the

FIGURE 43

Greatest Source of Current Competition: Consumer Loans

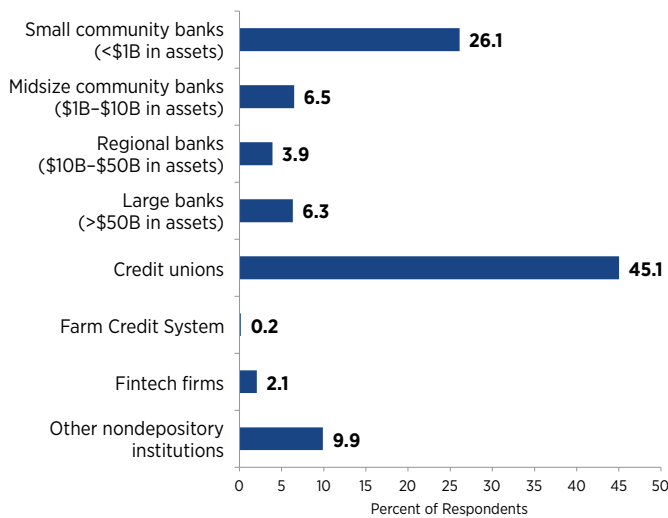


FIGURE 44

Greatest Source of Future Competition: Consumer Loans

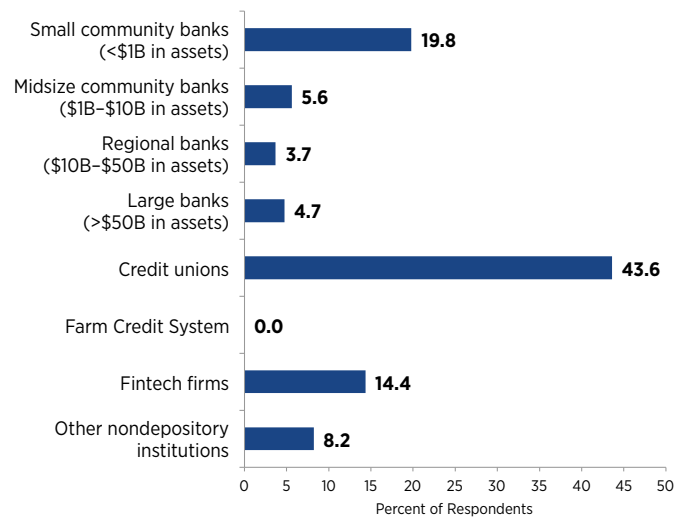


FIGURE 45

Greatest Source of Current Competition: Deposits

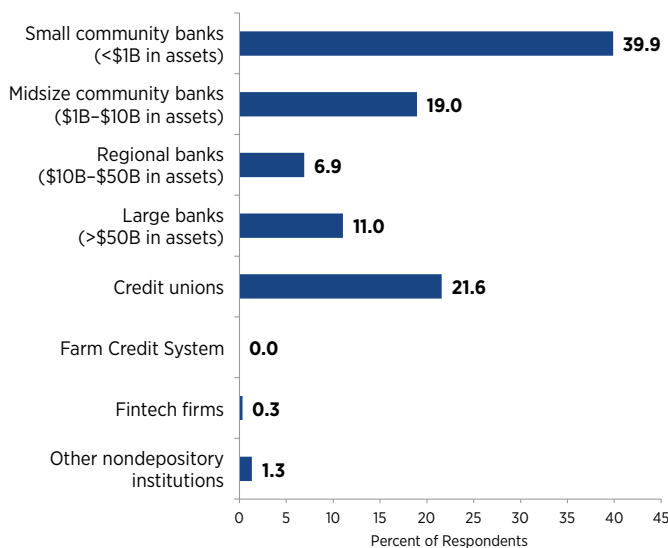
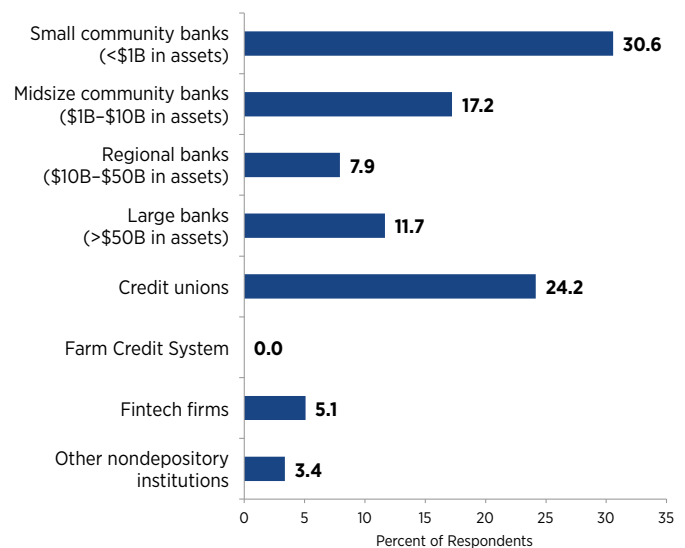


FIGURE 46

Greatest Source of Future Competition: Deposits



gap, once again, are fintech firms, which increase from near zero in terms of current competition to five percent for future competition.

Credit unions, meanwhile, remain significant competitors in deposits. Nearly 22 percent of bankers identified credit unions as their single largest current competitor, growing to 24 percent with respect to future competition. One surveyed banker noted challenges in “effectively growing our core deposit base in a very competitive environment fueled by the influx of credit union influence.”

Payment Services

Large banks were named by almost 27 percent of respondents as the greatest source of current competitive pressure for payment services (Figure 47). This percentage declines, however, to about 21 percent of respondents in terms of expected future competition (Figure 48). As was the case with other activities, this gap is being filled by fintech firms, which currently represent the largest source of competitive pressure for nine percent of respondents but, in terms of future competition, earn the top spot among 26 percent of respondents.

Competitive Outlook

The overall picture of competitive pressures presented by survey respondents

varies significantly based on type of activity and timing. Across most loan categories, the competitive pressures faced by community banks extend from other community banks. Exceptions include agricultural lending, where the Farm Credit System is a dominant competitor, and consumer lending, in which credit unions play an important role.

Time appears to be on the side of fintech firms, as they are expected to expand their competitive postures significantly in small business lending, commercial real estate lending, mortgage lending, consumer lending and payment services. This is an area of concern for some bankers.

“Fintech firms and large banks with in-house technological infrastructures will be able to go after our best small business customers by delivering rapid answers with little to no upfront paperwork,” one banker said. “No matter how great we are at customer service, relationship management, etc., we are concerned that our best clients will be peeled off to these competitors.”

The threats posed by fintech are not seen as necessarily existential, as the foregoing banker may fear, or as they have been described by some observers as recently as two years ago.³¹ They are more often viewed as incremental—for example, in the form of increased costs to help keep pace with technology. Some costs, such as

those incurred in hiring or retaining technologically qualified personnel, are specific. Other expenses are more general and often serve as a drag on productivity as bankers “struggle to stay abreast of technological changes and identify technology that they can afford.”

Many concerns appear predicated on the belief that fintech companies are trying to replace banks with their online offerings. But these firms could serve as partners rather than opponents. In this regard, the technology already in place at these firms may be “tailor-made to help banks expand and improve their businesses.”³² Some industry observers see these firms as “better-suited to be friends than foes to community banks.”³³

Although only one survey respondent directly referenced the benefits of “leveraging technology partners,” other bankers saw value in utilizing the internet, mobile banking and other technological innovations to improve customer service and efficiency. These views seem consistent with the idea that partnering with fintech firms offers a way for community banks to offer online services to customers while decreasing technology costs.³⁴ But they also reflect the still ambiguous role of technology in the community banking model:

“The main selling point [of community banks] to consumers is often a personalized

FIGURE 47

Greatest Source of Current Competition: Payment Services

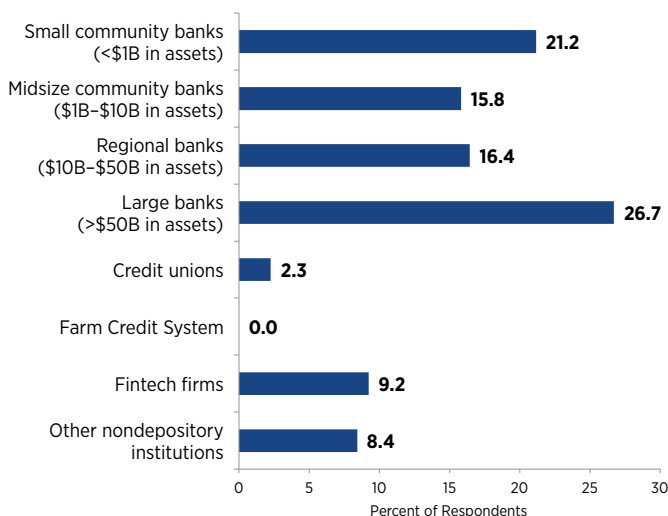
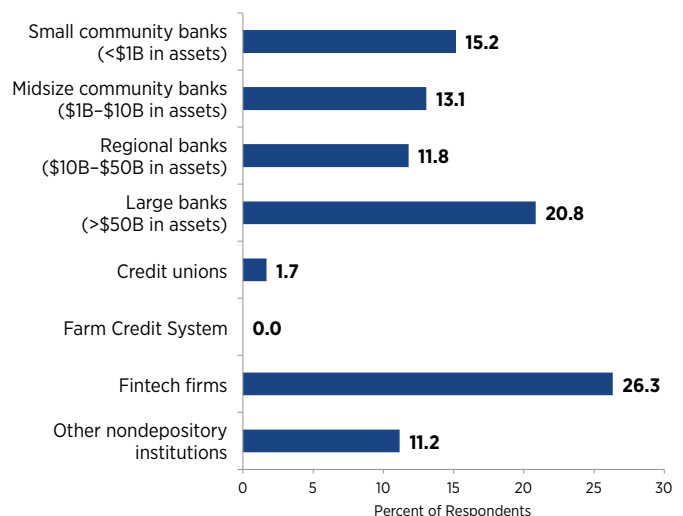


FIGURE 48

Greatest Source of Future Competition: Payment Services



experience,” one analyst observed.³⁵ “Yet they still need to offer customers the digital products and services they’ve come to expect.”

Market Structure

The total number of commercial banks insured by the FDIC decreased to 5,116 in 2016 from 7,087 in 2008, a decline of 28 percent.³⁶ This period was marked by more than 500 bank failures and abounding merger activity. New charters also collapsed, from more than 100 per year in the mid-2000s to only two since 2011.

Our survey findings reveal a continuing pattern of consolidation among community banks. For example, more than 11 percent of respondent banks said that they received and seriously considered an acquisition offer within the most recent 12-month period (Figure 49), and nearly 19 percent of respondents said that they made an acquisition bid during this same period (Figure 50). The former result was up from less than 10 percent in last year’s survey, while the latter result was down from its prior reading of more than 20 percent. The smaller emphasis among community banks on acquiring, relative to being acquired, also was observed previously.

Rationales for Offers and Bids

To better understand the rationales for consolidation, we asked bankers to indicate why they considered an acquisition offer or bid on another institution. An interesting commonality was found in efficiencies attributable to size. More than half of respondents said that economies of scale were very important in the decision to make a bid (Figure 51), and about one-third of them said that they were very important when considering an offer (Figure 52). This is consistent with the comment of one banker that “being part of a larger holding company lends its strength to our bank.”

The inability to achieve economies of scale seems consistent with the prominent role played by regulatory costs in offer considerations. Nearly half of surveyed bankers said that these costs, which are disproportionately higher for smaller banks, were “very important” in their decision to entertain offers (Figure 53). One banker

FIGURE 49
Have You Received and Seriously Considered an Acquisition Offer?

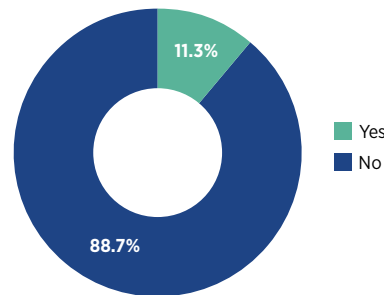


FIGURE 50
Have You Bid on a Target Institution?

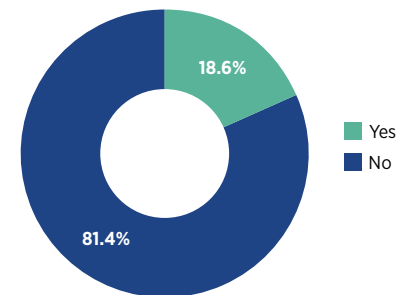


FIGURE 51
Reason for Making a Bid: Economies of Scale

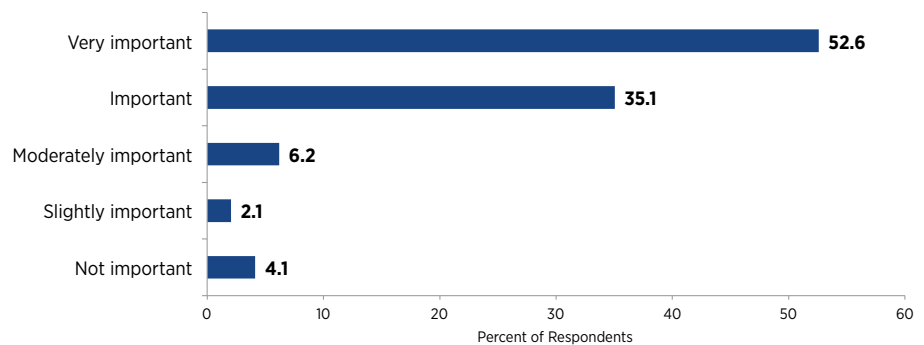


FIGURE 52
Reason for Considering an Offer: Inability to Achieve Economies of Scale

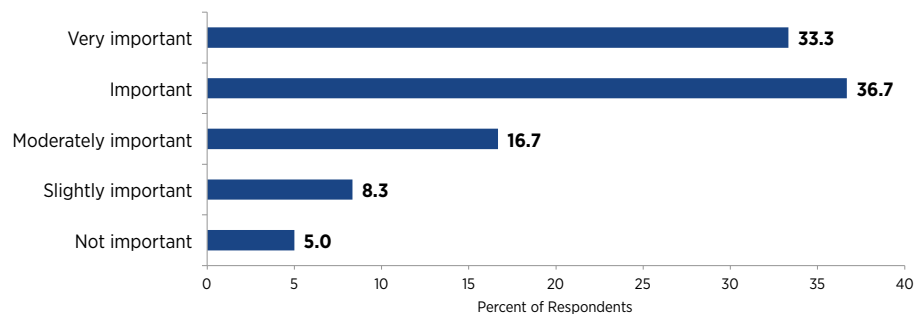
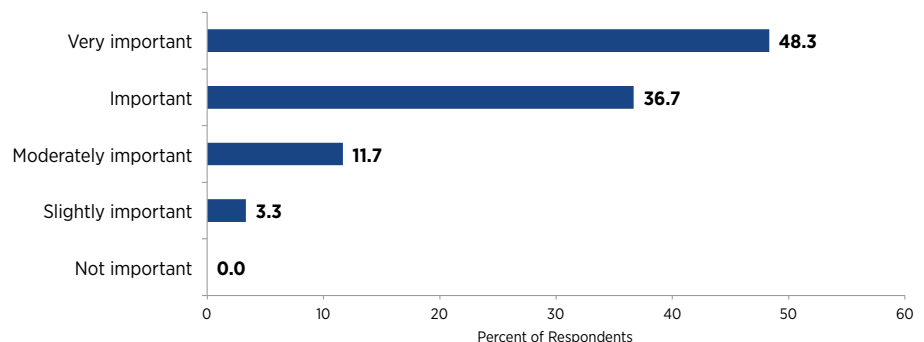


FIGURE 53
Reason for Considering an Offer: Regulatory Costs



commented on the contraction in the competitive landscape “as small institutions [are] not able to carry the costs related to increasing regulatory requirements.”

The marked interest in achieving economies of scale contrasts with the opinion of some bankers that bigger is not always better. In this regard, one banker said that the growth of some competitors creates “greater touch points with customers” for smaller institutions. Other competitive advantages may accrue from smaller, and potentially more nimble, operating structures created when competitors merge:

“Opportunities are created by mergers of other banks since we still offer an atmosphere where we know all of our customers,” one banker said. “This is difficult to maintain for other banks as they grow through mergers.”

Succession planning was of varying importance in decisions to consider or extend merger offers. About 33 percent of bankers said this factor was important or very important in their consideration of offers (Figure 54), while more than 40 percent said the topic was unimportant or slightly important. It was deemed unimportant by nearly half of banks making merger bids (Figure 55). One surveyed banker saw opportunities, however, in the “potential ability to acquire another institution whose owners are ready to retire.”

Nearly 40 percent of bankers identified access to new markets as a very important motive for making acquisition bids (Figure 56). Moving into different geographic markets may go hand in hand with acquiring new technology; in this regard, one banker identified opportunities arising from “the ability to expand our market presence outside of [the] current geographic market, and our new digital banking platform [which will enable us] to compete regardless of competition size.”

Expansion within existing markets was named by more than 30 percent of bidders as a very important motive (Figure 57). One surveyed banker noted the goal of better serving “a local clientele that appreciates doing business with a local institution.” That same banker also said that being “a vital part of the communities we serve” is what sets that bank apart from its larger competitors.

FIGURE 54

Reason for Considering an Offer: Succession Issues

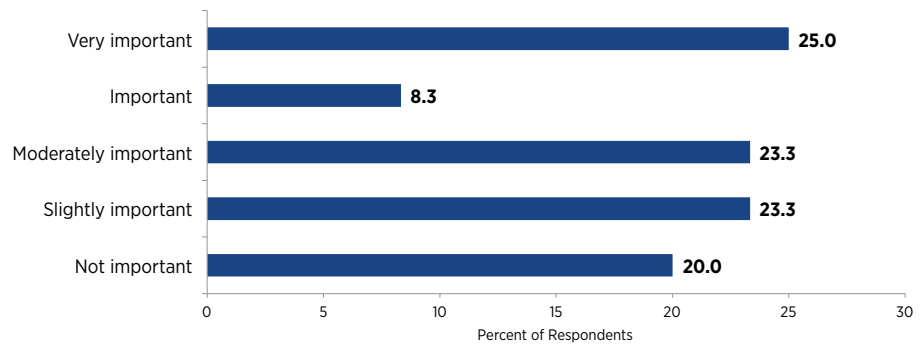


FIGURE 55

Reason for Making a Bid: Succession Planning

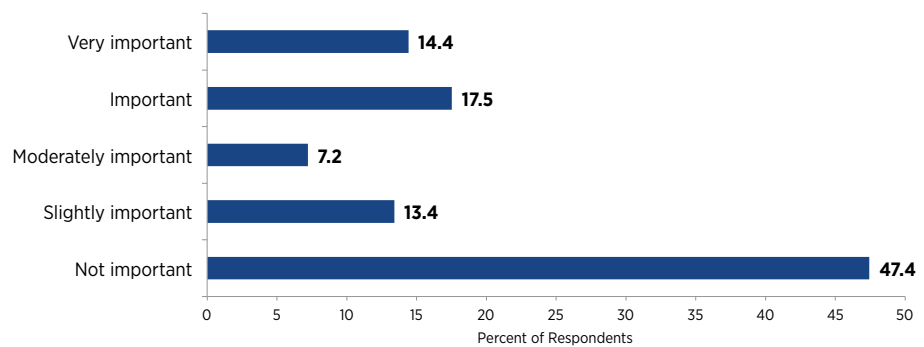


FIGURE 56

Reason for Making a Bid: Entry into New Market

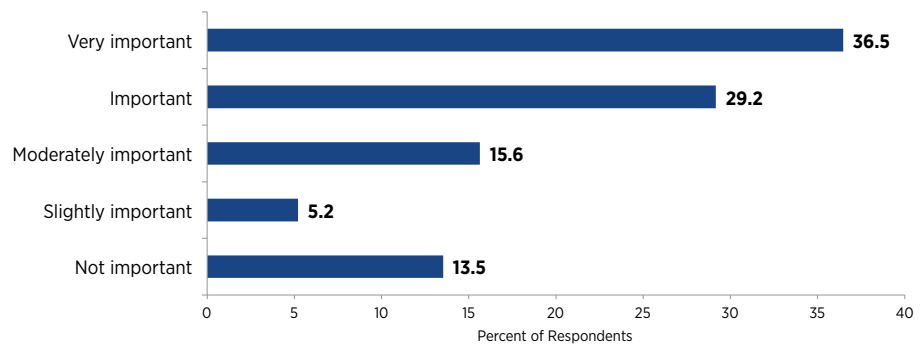
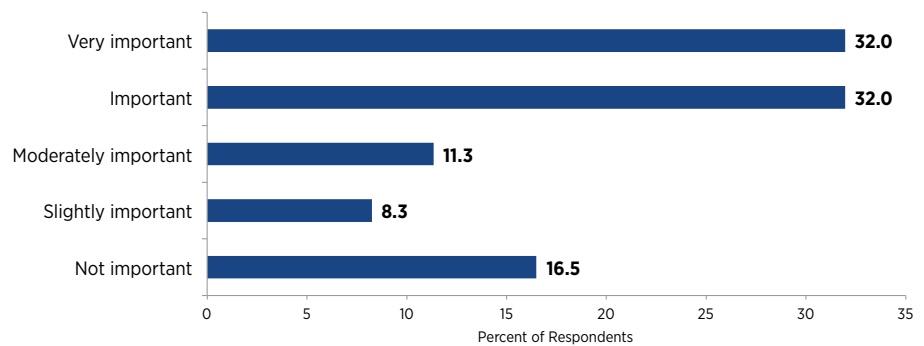


FIGURE 57

Reason for Making a Bid: Expansion within Current Market



A commonly cited motive for acquisition involves the capacity for the acquirer to capture opportunities that may be overlooked or that seem unattainable within the acquired entity. From this perspective, nearly 20 percent of bankers said that exploiting underutilized potential was a very important factor in their acquisition bids (Figure 58). About four percent of bankers cited as very important a desire to capture managerial talent (Figure 59). Both may be related, in part, to staffing challenges at many community banks, particularly in rural markets.

Impacts of Consolidation

Community bankers have framed the competitive landscape in recent years as a struggle for survival. This extends from the previously mentioned decline in the total number of banks and associated decline in branch locations from 83,638 in 2009 to 80,638 in 2016.³⁷ Given such a pronounced slide, it's not surprising that many bankers have wondered about the viability of the community banking industry.

But this may no longer be the case. The reduction in branches in 2016, for instance, was evident only among bigger banks. Community banks actually experienced an increase in the number of branches. This may be related to the dichotomy observed by one community banker between an “older generation that has most of the wealth and still utilizes our branch system, and a younger generation that will be inheriting the wealth and never frequents the branches. This causes us to keep high-cost branches to service a shrinking customer base.”

Another case for optimism can be found in an FDIC study, which identifies a “strong” correlation between “bank entry and exit and community bank profitability.”³⁸ From this perspective, the prevalence of prior bank exits and lack of entries may have created a “structural factor” from which a new balance of supply and demand for bank services is emerging.

Results from our survey similarly reveal hope, rather than fear, among those community banks left standing. One banker described opportunities presented by a

FIGURE 58

Reason for Making a Bid: Exploit Underutilized Potential

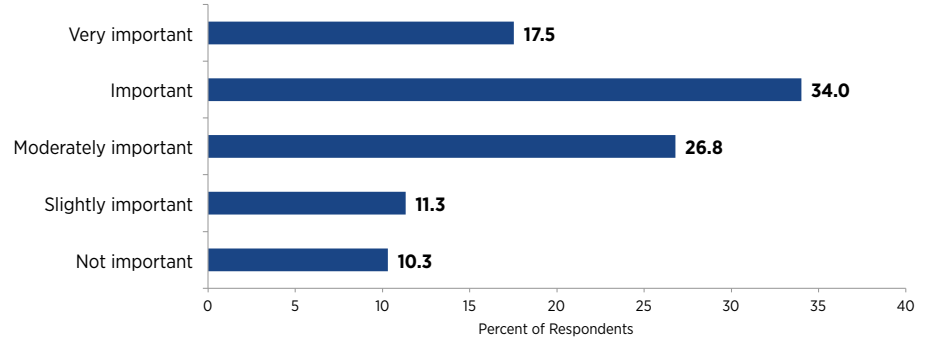
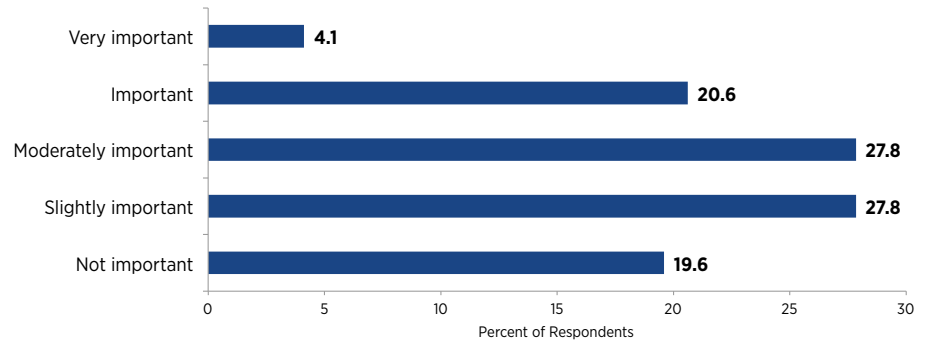


FIGURE 59

Reason for Making a Bid: Talent Acquisition



“thinning competitive landscape as more and more banks merge, which will ultimately lessen the number of competitors.”

Another interesting aspect of consolidation has been its influence on strategies for pursuing organic growth, which was often mentioned by our surveyed bankers. Bankers identified growth opportunities in several areas: 1) often-overlooked rural markets; 2) legacy markets, in which banks originated; 3) markets that are now under-served as a result of mergers or acquisitions; 4) local markets vacated by larger banks; and 5) markets where the consolidation of larger financial institutions created a void for individuals and small business that appreciate the services a community bank can provide.

Conclusions

This annual survey was created in the spirit of an ongoing nationwide effort by researchers, policymakers and regulators to understand the nature of community banks. Its timing, as the fourth in a series, follows the failure or merger of hundreds

of banks and the closing of thousands of branches in the aftermath of the recession.

This year's report occurs during a period of adjustment to new regulations that have concerned many bankers—but which, according to our survey, have associated costs whose rates of increase appear to be diminishing and which, in some cases, may be temporary rather than permanent. It also coincides with the introduction of new technologies that once threatened to upend the community bank business model—but which, some bankers say, have had fewer cost consequences than anticipated and may create opportunities for growth.

Through all of this, community banks have persevered. Their core profitability remains “relatively strong” despite declines in returns on assets that, according to the FDIC study, were “largely attributable” to the severity of the downturn in macroeconomic factors.³⁹ Their fundamental earnings model has been described as “sound.” And, perhaps most importantly, those that continue to survive may benefit from a more favorable competitive landscape:

“I feel that there are opportunities for growth by the community banks that can outlast their peers under the pressure to merge into larger institutions,” one banker said. “In our market, a community bank is the institution of choice for small businesses. Having the perseverance to stay in the game is the task.” ■

ENDNOTES

- 1 “Core Profitability of Community Banks: 1985-2015,” FDIC Quarterly, Volume 10, Issue No. 4 (2016).
- 2 The Survey Research Institute at Cornell University constructed the web interface used by respondents, handled the technical aspects of data collection and forwarded the data for analysis.
- 3 The remainder were primarily state-chartered thrifts.
- 4 “Is Small Business Lending Valuable to Banks?” Joe Peek, Communities and Banking, Federal Reserve Bank of Boston (Fall 2014).
- 5 Public Input on Expanding Access to Credit through Online Marketplace Lending, Department of the Treasury (July 17, 2015).
- 6 “Small Business Credit Survey,” Federal Reserve Banks of Atlanta, Boston, Chicago, Cleveland, Dallas, Kansas City, Minneapolis, New York, Philadelphia, Richmond, St. Louis and San Francisco (April 2017).
- 7 “Beyond the Cross-Sell: Deepening Relationship Banking,” Evan Sparks, ABA Banking Journal (June 7, 2017).
- 8 “10 Cash Management Products Your Bank Needs Now,” Chris Nichols, csbccorrespondent.com (Feb. 17, 2015).
- 9 In all figures, percentages represent the number of responses in a given category for banks that answered a particular question.
- 10 Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corp. and the Office of the Comptroller of the Currency (Dec. 18, 2015).
- 11 “Construction Loans Fall Victim to Concentration Risk Concerns,” Beth Mattson-Teig, National Real Estate Investor (Sept. 13, 2016).
- 12 “Senior Loan Officer Opinion Survey on Bank Lending Practices,” Board of Governors of the Federal Reserve System (May 2017).
- 13 A Qualified Mortgage (QM) is a type of loan with stable features that help make it more likely that a borrower will be able to afford the loan. Certain risky features that are not permitted are an “interest only” period, negative amortization, balloon payments and loan terms longer than 30 years. There are also limits on how much of a borrower’s income can go towards debt payments and a limit on excess upfront points and fees. See <https://www.consumerfinance.gov/ask-cfpb/what-is-a-qualified-mortgage-en-1789/>. QMs, which are more conservatively underwritten and therefore less likely to default, provide a measure of legal protection. Loans not meeting the QM requirements may fail to qualify to be sold through, or insured by, government-sponsored entities.
- 14 “Signs of Credit Deterioration, But Losses Remain Low,” Kevin Dobbs, SNL (July 20, 2017).
- 15 “More Small Banks Should Offer Business Credit Cards,” Vikas Bansal, American Banker (April 24, 2014).
- 16 Federal Deposit Insurance Corp., Statistics on Banking (Dec. 31, 2016).
- 17 Discrepancies between Figures 17 and 27 may be due to differences in the phrasing of questions.
- 18 “The Future of Banking,” Kate Stalter, U.S. News and World Report (June 29, 2015).
- 19 “Ease of Use, Data Security Are Priorities for Bank and Credit Card Mobile App Users,” J.D. Power (June 13, 2017).
- 20 “10 Cash Management Products Your Bank Needs Now,” Chris Nichols, csbccorrespondent.com (Feb. 17, 2015).
- 21 Economic Growth and Regulatory Paperwork Reduction Act, Federal Financial Institutions Examination Council (March 2017).
- 22 “Fresh from ABA 2017: Community Bankers Are Riding the Fintech and Regulation Wave of Optimism,” Frank Sorrentino, Forbes (March 2, 2017).
- 23 We acknowledge limitations in matching data on a relatively small number of banks that responded to the survey with industry aggregates. Our interpretations must be qualified accordingly.
- 24 It is worth noting that this estimated dollar amount is limited to community banks—in other words, it excludes the compliance costs at banks with assets greater than \$10 billion, which represent more than 80 percent of the entire banking industry’s assets.
- 25 See Integrated Mortgage Disclosures Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z), Federal Register 12 CFR Parts 1024 and 1026 (Dec. 31, 2013).
- 26 “Three Reasons Why the CFPB Should Delay TRID Enforcement,” Amy Tankersley, inman.com (May 26, 2015).
- 27 “Semiannual Risk Perspective,” Office of the Comptroller of the Currency (Spring 2017).
- 28 “Small Business Banking Customer Satisfaction Rebounds as Big and Midsize Banks Surpass Regional Banks,” J.D. Power (Oct. 30, 2014).
- 29 “Despite High Satisfaction, Many Fast-Growing Small Businesses Consider Switching Banks,” J.D. Power (Oct. 27, 2016).
- 30 “Senior Loan Officer Opinion Survey on Bank Lending Practices,” Board of Governors of the Federal Reserve System (April 2017).
- 31 “Fintech: An Existential Threat to Community Banks,” Rohit Arora, Forbes (Aug. 25, 2015).
- 32 “Growing Together: Collaboration Between Regional and Community Banks and Fintech,” Manatt, Phelps and Phillips LLP (Oct. 24, 2016).
- 33 “Fresh from ABA 2017: Community Bankers Are Riding the Fintech and Regulation Wave of Optimism,” Frank Sorrentino, Forbes (March 2, 2017).
- 34 “Fintech Comes to Regional and Community Banks,” Fintech Finance (Dec. 19, 2016).
- 35 “Is Fintech Small Banks’ Equalizer with Big Rivals?” Bryan Yurcan, American Banker (Dec. 7, 2016).
- 36 Federal Deposit Insurance Corp., Changes in Number of Institutions.
- 37 Federal Deposit Insurance Corp., Number of Institutions, Branches and Total Offices.
- 38 “Core Profitability of Community Banks: 1985-2015,” FDIC Quarterly, Volume 10, Issue No. 4 (2016).
- 39 Ibid.

Five Questions for Five Bankers

Five Questions for Five Bankers

A Summary of the Responses Given by State

To augment the 2017 National Survey of community banks that was administered in advance of this year's conference, interviews were conducted with bankers in select states. The objective of the "Five Questions for Five Bankers" interviews was to create dialogue and put the national survey results into context at the state level. The questions were posed to five community bankers selected by state bank commissioners in 30 states. Responses are listed alphabetically by state in this appendix.

The questions concerned economic trends; supervisory processes and examination; impediments banks face when making small business and/or commercial real estate (CRE) loans; factors affecting long-term planning; and the impacts of changes and innovations in banking technology. The five questions that were asked of all the bankers were:

1. What emerging local, regional and/or national matters are of most concern to your bank?
2. What are some time-consuming and/or burdensome supervisory processes for your bank?
3. What impediments do you face when making small business and/or CRE loans?
4. Outside of regulatory and supervisory issues, what factors are impacting long-term planning at your institution?
5. Do you consider changes or innovations in banking technology to be a threat or an opportunity for your institution?

Responses are summarized and presented in five major areas: local market conditions; regulation and supervision; small business lending; management structure and succession planning; and technology. The responses provide context for the data gathered through the survey and highlight some of the different challenges faced by community banks in different states.



Alabama

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Alabama bankers expressed concern about a lack of local economic growth. Although grateful to have auto manufacturers in their backyard, along with related supplier locations, bankers noted that these businesses do not transact with community banks but, rather, with large institutions, generally from corporate headquarters. The continued effect of military base closures, such as that of Fort McClellan, leaves a void as well. Bankers said they felt ostracized in their own markets because of the dying internal economies of rural markets.

Regulation and Supervision

Alabama bankers said that compliance with relatively new consumer lending regulations, especially the more rigorous disclosure requirements on consumer residential real estate transactions, is time-consuming and burdensome. These requirements have lengthened the time needed to execute a single transaction, thus diminishing return to the bank and, ultimately, its shareholders, while also failing to provide a tangible benefit to customers. Bankers said they would prefer to allocate more time to developing new business relationships and serving as better advocates for their communities.

From the standpoint of improving examination processes or bank supervision, bankers expressed doubt that basing the depth and frequency of examinations on the size of the institution is the best litmus

test to categorize risk. Instead, supervisory programs should be tailored to the complexity of the bank, regardless of size. They also criticized a duplication of efforts during supervisory examinations, as items already requested and uploaded electronically can be requested again by on-site examiners.

Small Business Lending

Alabama bankers said that small business loans and commercial real estate loans have been successful business lines in their markets. Although they have experienced low loss ratios in the past three years, they are concerned about implementation of the Current Expected Credit Loss (CECL) model.

Management Structure and Succession Planning

Bankers said long-term planning was impacted by a variety of factors, including economic conditions, personnel (board of directors, management and other employees), bank culture, geographic locations (existing and future) and customer behavior. Another issue affecting long-term planning is the age of the workforce: More experienced bankers are said to hold on to the old way of doing business and are less adaptive to technological change, while younger customers demand speed and a new way of doing things. This causes the younger generation to bank elsewhere, creating a potential age gap, over the long term, in customer bases.

Technology

Most bankers said they face strong competitive pressures from nonbank lenders that are not regulated (or not heavily regulated) but can, nevertheless, offer financing under aggressive terms. Despite this, bankers still see other in-market community and regional banks and credit unions as their main competitors. They have observed competitors offering liberal terms on requirements governing equity contributions, guaranties and loan-to-value ratios, while also extending long-term, fixed-rate pricing options that Alabama community bankers deem imprudent given their balance sheet structuring standards.

Bankers said technology is increasing costs for community banks. Requirements from the Federal Deposit Insurance Corp. and the Consumer Financial Protection Bureau are increasing the workloads of community bank information technology (IT) departments. They said that it is easier for larger institutions to attract qualified IT personnel and pay enough to retain them.



Arkansas

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Bankers in Arkansas said that the community bank model remains feasible despite considerable challenges. “In rural America, I don’t think they’re going to be able to function without a community bank where you can sit and talk to somebody,” one banker said. Another banker noted that community banks must continue to reduce expenses by leveraging technology and building scale.

Challenges in the community banking industry include economic uncertainty; decreasing and aging populations in the communities served; a retrenchment in the manufacturing sector; and intensifying competition, primarily from nontraditional lenders. One banker said that the uncertainty emanating from Washington, D.C., is of great concern to him and to his bank’s customers. He went on to say that uncertainty is increasing customers’ indecisiveness when it comes to making investment or other longer-term financial decisions. Another banker said, “We need some certainty, and we need stability.”

Uncertainty regarding healthcare also is prevalent, with one Arkansas banker indicating that losing a hospital in some of the markets his bank serves would be a threat to the bank and to the survival of the communities. He noted that one area hospital has already closed. Another banker said that his community is struggling to save its hospital.

The loss of population in rural communities likewise is a concern. “Our best high school graduates are going off to college, but they are not coming back,”

one banker said. Another banker cited an aging population as a related challenge. This same banker pointed to the additional headwind of job losses in manufacturing: “And we’re struggling because, not only are those manufacturing jobs leaving, [but] the jobs that they replace those with are usually lower scale,” he said.

Regarding competition, bankers said that alternative sources of agricultural financing, often secured at relatively favorable interest rates, are reducing loan demand. For example, an alternative lender has been aggressively developing business in one banker’s rural area. This lender offers to finance crop production loans at 2.5 percent or 3.0 percent and agricultural equipment loans at 3.5 percent. One banker said that credit unions are “getting their foot in the door,” particularly in the area of installment lending.

Regulation and Supervision

A persistent theme arising from survey responses was the unintended consequences of new regulations. One Arkansas banker stated that regulators are “trying to regulate the uncertainty out of banking.” Some bankers reported that efforts to comply with a growing volume of regulations and more restrictive regulatory expectations are resulting in employees doing “unnecessary” work.

New regulations governing residential mortgage loans seem to be discouraging lower-income customers from pursuing homeownership due to additional costs. One bank with a mortgage division that originates real estate loans nationwide

increased its compliance staff from one employee to 20 employees. The new regulations also seem to be frustrating loan applicants due to the longer time to fund home loans. “We know these people,” one banker said. “They’ve been banking with us for 30-something years. We know what they can afford and what they can’t afford. And these people are just baffled over all this regulation. It’s the consumer saying, ‘I don’t understand why we have to do all of this.’”

Another banker called the new TILA-RESPA Integrated Disclosure Rule under the Truth in Lending and Real Estate Settlement Procedures acts, also known as TRID, “absolutely exhausting.” Yet another banker noted that an unintended consequence of TRID is an increase in the time from loan application to loan closing. Ambiguity surrounding high-volatility commercial real estate is another concern among bankers. Other areas in which bankers see regulatory expectations as unreasonable, or where regulations are outdated, include appraisals and evaluations of real estate; asset/liability management modeling; Regulation W; the Bank Secrecy Act; and the Community Reinvestment Act.

Small Business Lending

Regulatory requirements were identified as an impediment to small business lending. Obstacles cited included the ability of small businesses to generate adequate cash flow; declining economies; and cumbersome requirements established by the Small Business Administration (SBA). One banker conveyed that it takes an inordinate

Arkansas *continued*

amount of time for the SBA to honor a guaranty, while another said that his bank no longer makes SBA loans because of the documentation requirements. A third banker noted that the cost of expertise and information systems needed for SBA lending is high.

Management Structure and Succession Planning

Bankers admitted challenges in finding talented individuals to work in their banks and to serve as directors on their boards, especially in smaller, rural communities. Bigger banks can offer higher salaries and require responsibilities to be concentrated in fewer areas. Training members of the millennial generation was cited as an ongoing challenge. Of significant importance, bankers saw problems arising from current regulatory expectations of increased involvement by board members in day-to-day issues. One banker said that bank directors are challenged to keep pace with the regulatory environment, which has discouraged director involvement with their affiliated institutions.

Another major issue facing community banks is the aging of directors, who are not always knowledgeable with respect to new technology, according to one banker. Survey respondents also cited a lack of appeal to living in rural communities and salary differences relative to larger, urban markets as significant roadblocks to recruiting and retaining qualified talent. In addition, individuals qualified in certain specializations, such as information technology and compliance, are difficult

to find. As a result, some grass-roots initiatives are underway among local banks and neighboring academic institutions, such as high schools and colleges. One bank has established a summer internship program that is designed to attract interest from local high schools.

Technology

Innovation in banking technology is viewed as both an opportunity and a necessity. One challenge bankers cited in this area is working with third-party data processors. “We absolutely view it as an opportunity,” one banker said. He noted, however, that management is hesitant to adopt new technology before regulations governing its use are implemented. Another concern he voiced is the potential for blockchain technology and bitcoin digital currency to take over payment systems. If that occurs, he believes that bank revenue models will change overnight.

Another banker at the same institution highlighted the risk associated with waiting for regulations before utilizing new technology, namely that financial technology companies will take advantage of that time to make further inroads. The same banker shared that keeping pace with technology embraced by banking customers is an imperative.

Colorado

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Colorado bankers recommended that the advancement of community banks be supported by higher-level officials in government. In relation to cannabis banking, they said more clarity is needed.

One banker indicated that the overall pace of change (e.g., technological, economic, regulatory) should be commensurate with customer preferences. Another noted that the national regulatory environment continues to reduce his ability to provide local clients with the flexible and personalized products and services that help set community banks apart from much larger competitors. In relation to issues affecting their communities, bankers said that financial literacy is limited among emerging business leaders and consumers. Some community bankers have tried to address these shortfalls by partnering with local academic institutions; such efforts, however, have had limited success because of limited resources.

On competitive conditions, bankers said the Farm Credit System remains the biggest lending competitor in rural markets. In addition, credit unions are posing significant challenges in consumer banking. Some bankers observed that credit unions are more noticeable now, given the rate and level of consolidation in the credit union industry. Some bankers said that it is difficult to compete with credit unions due to what bankers called an uneven playing field created by tax advantages and different regulatory and oversight structures.

Regulation and Supervision

Bankers noted that competitive pressures and regulatory developments are influencing the products and services offered in certain banking markets. The bankers mentioned that they are continuously adjusting any new product and/or services to new regulatory guidelines. Currently, bankers spend a lot of effort on regulatory matters that, in their opinion, produce little, if any, real protection for their customers or the banking system as a whole. One banker said that compliance with the

Home Mortgage Disclosure Act (HMDA) is cumbersome, requiring an investment of over 300 hours for 250 loans.

The implementation of the Current Expected Credit Loss (CECL) model is expected to require significant changes to the data bankers collect and to how they are analyzed. Bankers said that, although the general focus on CAMELS ratings remains a valid way to evaluate the financial soundness of a bank, the time to prepare for and work with regulators on safety and soundness and specialty examinations is, at times, unbearable. With regard to regulatory relief, the bankers directed attention to an easing of the Ability-to-Repay and Qualified Mortgage rules. By “right-sizing,” they said, banks would be better able to meet the credit needs of their communities.

Small Business Lending

Colorado bankers continue to struggle to keep up with technology and cybersecurity. In addition, low unemployment levels and a lack of training programs make it increasingly challenging to find good potential employees. Some bankers noted that they have shared services with their sister banks in an approach that has benefited both institutions, but talent acquisition is still generally problematic.

Bankers are experiencing competition from virtual competitors in mortgage lending. According to some bankers, underwriting standards are loosening for commercial lending; one banker, however, said that credit standards have tightened across the board. Another banker noted that he has often taken residential real estate as additional collateral in order to compensate for any collateral shortfalls on small business loans; however, he added that “now that this collateral avenue will be HMDA-reportable, we are going to be less likely to utilize that source of equity, [which] ultimately reduces the availability of small business credit.” Other impediments to making small business loans noted by bankers related to credit quality (e.g., less qualified applicants) and small-business lending competition.

Management Structure and Succession Planning

Colorado bankers discussed difficulties faced in attracting and retaining specialty staff (e.g., compliance staff). Succession planning is a concern, as some bankers are facing retirement. One banker noted that it has been especially difficult to attract and retain younger bankers in his rural locations; if people who grew up in the area are hired, on the other hand, they tend to stay long term. Though some bankers have considered sharing services, most have not found a workable plan to address the underlying compliance issues that a successful, well-executed sharing agreement requires.

Technology

Bankers expressed concern that outside competitors have been aggressively investing in technology, while smaller banks have been lagging. They noted that, over the past three years, some banks have changed core banking system providers in order to provide additional services to customers. Those new services include mobile banking apps, real-time transaction processing to allow more flexibility in using debit cards, and outsourcing of networks in hopes of reducing dependence on in-house servers.

Technology costs have not been declining, according to some bankers. One banker noted an increase in technology costs on an annualized basis, though when viewed relative to total asset growth, there was a corresponding decrease in costs. This was the result of a merger.

Another banker reported plans to provide better mobile banking options in order to retain key customers. Two bankers noted that regulatory requirements have increased technological costs. One example cited new regulations for residential real-estate lending, which necessitated the purchase of an additional loan document preparation program. Another example was the adoption of an enhanced asset/liability management program. Another banker noted that the migration to a cloud-based server system has worked out well for the bank and its customers.



Connecticut

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Connecticut community bankers ranked the national, state and local economies as chief concerns. With regard to the Connecticut economy, bankers highlighted a declining and aging population; the exodus from the state of young people, including recent college graduates; and, finally, the state's fiscal instability and its growing effect on local schools and increased property taxes.

Bankers also noted Connecticut's tax climate as an impediment to growth, citing the recent departure of high-profile businesses to other states offering a more business-friendly environment. Borrowers have expressed similar concerns to community bankers, which translate into deferred business expansion and fewer commercial lending opportunities.

The loss of people in the state is having a direct impact on recruitment and retention of staff; of particular concern is the difficulty in attracting skilled credit analysts and information technology (IT) and cybersecurity professionals. In response to the need for skilled credit analysts, one bank created a training program and proceeded to train five analysts, only to have all but one leave the bank for other opportunities. Given the significant resources allocated to the program, the bank has since decided to suspend it.

Bankers remain focused on financial literacy and the need to educate the public on the basics of finance and budgeting. In this regard, community banks are investing resources in supporting such initiatives; one bank implemented a "Teacher Grant Program" in which the bank develops financial education curriculums directly with teachers. This same institution is targeting young engineering professionals, recently hired by a large defense contractor, with educational efforts to help them prepare for their financial futures.

Regulation and Supervision

Connecticut bankers said that burdensome regulations and, in some cases, burdensome federal supervisory processes have significantly impacted the delivery of financial products and services. Bankers described difficulties with compliance resulting from the myriad of regulatory changes over the past few years. In their view, supervisors need to provide greater support for community banks. They also noted that the "one-size-fits-all" regulatory approach is burdensome and inefficient.

Bankers recommended that Congress recognize that the regulation of community banks should be based on size, risk profile and well-capitalized status. Rising compliance costs for community banks caused one banker to say that "I have as many BSA (Bank Secrecy Act) staff as I have lenders." Another identified compliance staff growing from five to 12 people within just two years.

Bankers also said that other recent regulatory changes designed to benefit the consumer, such as the Integrated Disclosure Rule under the Truth in Lending and Real Estate Settlement Procedures acts (TRID), have resulted in a more burdensome process that considerably delays closing for consumers. In some cases, compliance costs are altering the community bank model: Banks that previously were primarily portfolio residential lenders are now moving to the sales model. This trend is dynamically changing relationships with customers and is causing some banks to consider moving away from residential lending altogether.

Connecticut bankers noted the following opportunities for improved exam efficiencies: a risk-focused examination approach; greater consideration of the impact examiner trainees have on the bank during the exam (and the impact new regulations have on the exam process as examiners are still learning about the

regulatory changes); and development of off-site examination processes to improve exam efficiencies. (With less time lost in examiner travel to the bank and less impact for bank staff with the reduced on-site examination presence, the bank and regulatory authorities would consume less time and other valuable resources.)

Bankers expressed great uncertainty with the implementation of the Current Expected Credit Loss (CECL) model, expansive data requirements under the Home Mortgage Disclosure Act (HMDA) and the Bank Secrecy Act. Compliance with Unfair, Deceptive or Abusive Acts or Practices rules remains an ongoing challenge. Areas suggested for immediate relief include increasing Currency Transaction Reporting (CTR) filing thresholds from \$10,000 to \$20,000 and increasing the appraisal threshold from \$250,000 to \$500,000 (which one banker estimated would save \$2,000 per small business owner).

Small Business Lending

Community bankers said many more dollars are chasing fewer deals. Further adding to the competitive environment are the increased activities of out-of-state banks, credit unions and the Connecticut Department of Economic and Community Development (DECD). Bankers continue to advocate for DECD's role as one which offers credit enhancements for loans while leaving the actual lending to banks.

Community bankers were most concerned with the 30-year fixed commercial loans offered by some banks and credit unions. While community bankers said they have negotiated on price, adjusted some covenants or assumed additional interest rate risk, they have not given any latitude on credit or asset quality. They remain committed to maintaining strong underwriting standards, a practice which benefited the industry during the banking crisis.

Connecticut *continued*

Management Structure and Succession Planning

Connecticut bankers said that given the low-profile nature of banking careers, difficulties in recruiting millennials and recent college graduates are unsurprising. As such, banks are deploying considerable time, money and human capital in training. Bankers are supportive of Connecticut Bankers Association (CBA)-sponsored programs and others, such as those from the Connecticut School of Finance and Management (CSFM) and the Stonier Graduate School of Banking. Bankers responded positively to the recently held weeklong Banking Boot Camp, an initiative of banks, local chambers of commerce and the state's Department of Banking. It is geared toward introducing different areas of banking to college students.

Long-term planning includes a focus on succession as well as staff recruitment, retention and development. Multibank holding company structures were said to afford opportunities for employees to move among subsidiary banks and share resources in critical areas. An absence of credit and lending programs was said to have resulted in shortages of commercial and industrial lenders. Increased lending through the Small Business Administration (SBA) has increased demand for SBA lenders; finding qualified trained lenders is difficult given the marketplace demands for these individuals.

On a positive note, one banker highlighted a recent college graduate whose hiring in the operations area led to increased technology applications and a risk-based approach to operation processes. All of the community bankers agreed that staff recruitment, retention and skills development are critical to the bank.

Technology

Bankers said that fintech has extraordinary potential for the banking industry as it pushes the industry to expand and to be responsive to the growing needs of its customers. Inaction could result in loss of customers and market share.

For smaller banks, fintech represents a potential partnership opportunity that can allow them to meet customer expectations for instant online approvals, something larger banks seem to do better given their technology base. Community banks continue to invest in information technology (IT), and many bankers highlighted the need for core bank system providers to be agile and more responsive to their changing needs.

Bankers are re-evaluating physical branch expansion versus IT investments that can respond to customers' expectations in delivery of products and services. Embracing technology and integrating it throughout the bank was described as a pathway to growth. One community banker discussed the creation of an "Innovation Center" that brought IT, business development, marketing and product management under one director, resulting in a very collaborative environment.



Georgia

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Georgia bankers expressed concern with conditions in some local markets. In predominantly rural southern Georgia, bankers are worried about competition from the Farm Credit System (FCS), whose lending associations enjoy a rate advantage given their tax-exempt status. Bankers also noted that the FCS continues to expand its loan products and offerings well beyond its original mission.

Overall, growth in the region was described as slow but steady. In certain portions of the state, in mixtures of rural and urban markets, bankers are concerned about the advantage credit unions have in pricing deposits and funding their balance sheets. Economic conditions in those areas were described as generally satisfactory, but improvements in education and workforce development would help attract additional business to the area.

Bankers in northern Georgia, specifically those located around the Atlanta metropolitan area, describe real estate markets as quickly improving after languishing for years. These communities are experiencing a positive spillover effect in residential markets, particularly in lower price ranges. While this has been beneficial for loan production, it is causing an increased concentration in construction loans, which has drawn the attention of regulators. Community bankers in this market noted that their strongest competition comes from regional banks, particularly for credits of \$1 million or more.

Regulation and Supervision

Community bankers from all regions of Georgia indicated that their most recent safety and soundness examinations went well; however, some bankers observed that examination teams are staffed at times with too many trainees, which results in additional work for bank staff. A couple of bankers who recently went through compliance examinations characterized

the examinations as fair and the examiners-in-charge as helpful.

All banks noted that compliance costs continue to be a concern as staffing needs increase. Recent changes related to the TILA-RESPA Integrated Disclosure Rule under the Truth in Lending and Real Estate Settlement Procedures acts have resulted in longer processing times, with greater expense to the consumer. One bank no longer offers residential mortgages due to concern over regulatory compliance under the Consumer Financial Protection Bureau (CFPB).

Small Business Lending

Community bankers from southern and central Georgia indicated that small business lending continues to be profitable. Large regional banks are the primary competitors; however, they tend to have more rigidly structured products, which gives community banks a competitive advantage when a prospective customer doesn't "fit neatly in a box."

There is concern regarding the implementation of Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which will require the CFPB to collect industry data on small business lending. Bankers fear this will increase regulatory burden and create restrictions that will, ultimately, decrease lending to these businesses.

Bankers operating in northern Georgia described a small business lending environment that is much more competitive, particularly with respect to large regional banks. Community bankers indicated that loans in the \$250,000 to \$500,000 range are most profitable, noting that competition for deals of \$1 million or more typically results in pricing and terms that are prohibitive. Community banks are still largely dependent on net interest margin to generate earnings, so it is inefficient to tie up funds at a low fixed rate for an extended period.

Management Structure and Succession Planning

Community bankers from central and southern Georgia noted challenges in attracting and retaining experienced bankers and other personnel, especially now that large-scale bank training programs are a thing of the past. Banks are more often developing their own talent internally through an apprenticeship program, or recruiting externally, which can be costly.

Community bankers in northern Georgia have found it easier to recruit and retain experienced bankers due to the high level of consolidation in this market, as well as in neighboring Atlanta. Banks located near the Atlanta metropolitan area are frequently approached by experienced bankers who want to leave larger banks to work for a smaller institution.

Technology

Community bankers across Georgia share similar views on technology, seeing it as both a great opportunity and a threat. Technology has allowed banks to do more with less staff, which has been very helpful from a personnel expense standpoint. However, a large portion of those savings has been absorbed by greater spending on technology.

The technology demands and expectations of consumers and businesses in metropolitan areas are cost-prohibitive for most small banks. Bankers also noted that they are incurring significant technology costs related to compliance and are continuing to seek efficient solutions from third-party vendors. Community bankers expect to spend less on brick-and-mortar facilities going forward but anticipate continued spending on technology. They are not seeing a lot of direct competition from fintech companies at this point, but they are cautiously investigating opportunities to partner with them.



Idaho

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Idaho community bankers remain concerned about credit unions, which are exerting competitive pressures in commercial and automobile loans and are also recruiting banking staff from depository institutions. They said that the economy is generally improving, with companies like Micron, Simplot and Albertson's creating job growth.

Regulation and Supervision

Bankers said they continue to find the Truth in Lending and Real Estate Settlement Procedures acts to be the most burdensome regulations. They also are concerned about the implementation of the Home Mortgage Disclosure Act and the Current Expected Credit Loss (CECL) model. One community banker commented that rules for CECL compliance, in particular, are unclear.

Several Idaho bankers are concerned about obtaining evaluations for real estate, citing issues with expense, time commitments and the relative value of appraisals versus evaluations which, according to regulatory guidance, are not much different from each other. Although the issues in Idaho are evaluation-specific, obtaining appraisals is also difficult.

Small Business Lending

Alternative sources of financing make small business lending difficult; most notably, financial technology providers, like SoFi and Kabbage, can underwrite differently than banks and, thereby, originate loans at low cost. Several bankers stated that some customers who would traditionally qualify only under the Small Business Administration (SBA) are now getting loans from larger banks, without SBA guarantee support, which results in faster turnaround times and a loss of business for community banks. In addition to larger banks, credit unions also have begun originating SBA loans. Credit unions and out-of-area lenders are increasingly competitive.

Management Structure and Succession Planning

Idaho bankers are particularly concerned about the shortage of community-based lenders within the state. One characterized this as a "staffing crisis for lenders," because the workforce is reaching retirement age. They said that in small banks, lenders undertake a wider range of duties with customers, whereas, in large banks, they are supported by a team. Some loan officers now want to do business development and not credit analysis, which results in weaker credit proposals. Competition for loan officers has driven salaries to six figures.

Technology

Changes and innovations in banking technology are said to create both an opportunity and a threat. One banker described significant competitive pressure to deploy new products and services quickly; however, much of this technology is expensive and could be damaging to the bank if it were inefficient or not well-received by customers. Another community banker mentioned that many institutions have been providing services at little to no cost and that implementation of technology may result in more customer fees.

Community bankers also mentioned that third-party vendor concerns are related to contract issues and exclusivity clauses. Further, vendors in Idaho are increasing costs for products and lack transparency. Bankers suggest that regulators should review third-party vendor activity, especially when it comes to exclusivity contracts that trap banks into business relationships, regardless of whether the vendor is continuing to perform adequately.



Illinois

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

The most concerning issue to each of the bankers interviewed was the financial stability of the state of Illinois. As interviews were being conducted, the state was approaching the end of its fiscal year and, once again, the prospects of adopting a budget were slim. The state went two years without a budget, and the credit agencies were threatening to drop it to “junk” status. (In July, Illinois lawmakers overrode the governor’s budget veto; though the state now has a budget, Illinois still faces fiscal challenges.)

Bankers were concerned with the status of Chicago public schools, struggling school districts and several state colleges. Other related concerns included the loss of population; a lack of businesses moving into the state; threats of businesses relocating to nearby states; and the overall ability of bank customers to continue borrowing and to make payments on outstanding obligations with cash flows that are heavily dependent on money owed by the state.

Bankers indicated that local concerns are largely the same and, generally, are tied to the state’s financial situation. One of two central Illinois bankers expressed concern with an increasing crime rate. Both of them indicated that the biggest employers in some of their markets were relocating, either out of state or to the Chicago area. On a national level, all of the participants indicated that interest rate compression was a concern, along with the uncertainty surrounding health care.

In discussions of third-party relationships, all of the bankers indicated that vendor management was a big issue. One had recently gone through an acquisition and said that vendor management during that process was especially challenging and convoluted.

All of the bankers indicated that competitive forces were at the forefront of their thoughts. None of them, however, raised specific concerns with emerging competitors. Rather, the competition appears to be

coming from traditional competitors, such as local banks in their markets. One of the Chicago-area bankers, as well as one of the central Illinois bankers, said underwriting standards and loan covenants were being relaxed.

Regulation and Supervision

A banker from one of the larger community banks indicated that compliance examinations were the most burdensome of all regulatory examinations. Bankers suggested that it would be much easier for them if communications were amplified and more transparent in this specialty examination area. They indicated that enhanced communication would tie in with a risk-based approach and suggested standardized monthly or quarterly reporting.

Bankers from other large community banks identified challenges presented by the Community Reinvestment Act (CRA) and Unfair or Deceptive Acts or Practices. They said that because so much of this type of regulation is based on interpretation, they are spending a large amount of time and resources trying to ensure compliance with fee disclosures and are looking at compliance monitoring and hidden fees. In addition, due to the challenges of Regulation Z and “Know Before You Owe” regulations, some bankers are outsourcing residential mortgages rather than making the loans themselves.

Bankers said that, while they fully support a robust compliance system, specifically the CRA, they need some relief. A midsize bank located in central Illinois also indicated that the CRA was their biggest complaint, mostly due to the fact that there is too much interpretation and that it is too “nuanced.” They know they are serving the low-to-moderate income population in their area—not only through their lending programs, but also through community investments—but can never be sure they are doing enough.

All of the bankers interviewed indicated that they were happy with their regulators.

One of the smaller banks noted that they have no complaint regarding the supervisory processes because the processes are dictated by regulations. In terms of recommendations, one of the smaller banks suggested a more streamlined process for gathering information requested in opening examination letters, more off-site work by the examiners and reduced frequency of examinations. A few banks indicated that the information technology systems employed by the examiners need to be modernized.

Small Business Lending

Bankers at two smaller banks, both with assets around \$100 million, indicated that the CRA is an impediment. One stated that balancing credit and repayment risks with the bank’s responsibility to lend within its CRA community was an issue, as some CRA lending opportunities represent higher risks than the bank and/or the regulators are willing to accept.

A banker at one of the larger community banks indicated that the lender has not seen a significant increase in competition for small business or commercial real estate loans. In contrast, a banker at another of the larger banks in Chicago indicated that competition is very strong, though not from virtual entities but, rather, from traditional banks. That banker insisted that he’s still successful with Small Business Administration (SBA) loans. He said his bank is experiencing strong competition on rates, structure and covenants. The banker said he has stayed consistent in underwriting, fees and monitoring for concentrations.

One of the smaller banks indicated that with SBA loans, it is competing on turnaround times. As a result, the bank has engaged an entity to develop a small lending platform to gain efficiencies in this market segment.

A banker at a midsize bank said the lender sees competition for loans in denominations of \$100,000 to \$500,000 from traditional lenders, while it is seeing

Illinois *continued*

more competition for smaller loans—such as for “mom and pop” businesses—from emerging nonbank lenders. As a result, this bank has recently entered into a contract to explore creating a new online lending platform aimed at small business loans in smaller denominations and was trying to provide current customers with new products.

Three of the five participants indicated they are seeing traditional competitors loosening underwriting standards in all of their lending areas due to increased competition. With respect to noncompetitive factors, a banker at one of the larger banks indicated that the lender has concerns with economic drivers changing in the marketplace. For example, the banker is seeing companies go overseas and changes in the consumer retail market (that is, the transition to Internet retail from “bricks-and-mortar”). The banker also sees technology as an important noncompetitive factor.

Management Structure and Succession Planning

Finding and retaining specialists with respect to the Bank Secrecy Act (BSA) and anti-money laundering regulations is a widespread problem among interviewees. When we asked these questions last year, the problem was more of a concern in rural areas. This year, it was highlighted by bankers at both of the Chicago-area banks. One recognized the need to find a highly qualified individual to ensure compliance with BSA/anti-money laundering requirements because it was “onboarding” clients in digital currency and medical marijuana; this was a priority for the lender. The other indicated that, because larger banks in the area pay more, retaining qualified BSA and CRA specialists is a challenge.

None of the participant bankers indicated that succession planning is a concern. None are sharing services, although some have considered it. (Ironically, it is the two larger banks that have done so.) Two of the participants indicated that vendor

management would be a prime area for sharing services if it could be done right. A core bank system provider was mentioned as a possibility; a banker indicated that there are only a handful of these firms. Another banker asked: “Rather than having a thousand banks perform due diligence on Jack Henry (a core bank system provider), for example, couldn’t there be a way to share this task?”

Technology

Bankers said they have spent significant resources to upgrade systems and platforms. They see this as an essential investment not only to stay competitive, but also to keep their customers safe. At the same time, one banker doubted that core bank system providers could keep up with technology because they are not fluid enough. None of the bankers said they have made changes related to core bank system providers.

In terms of opportunities, technology permits banks to provide services to remote customers, opening the door for out-of-area businesses. Several of the bankers indicated that they are looking at fintech as an opportunity rather than a threat. Two of our participants said they are partnering with new companies to develop a small lending platform that will, ideally, give them an opportunity to gain efficiencies in an area in which they previously struggled.

Finally, one of the larger banks also sees an opportunity to acquire smaller institutions that cannot keep up with the cost and pace of technology.



Indiana

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Indiana bankers described market conditions as generally sound and stable. Pockets of the state were said to have challenges, but overall, bankers felt that the business environment was positive. While the agricultural market has displayed some stress, it has not yet declined to the level feared by some.

Bankers highlighted the continued need for an economic environment that stresses both local and national growth. Regional uncertainty looms given budget discussions in Washington, D.C., particularly with respect to the potential capping or reduction of farm subsidies. Tax reform also could have a considerable effect on banks' and bank holding companies' stock prices. Bankers said that a lack of action on anticipated reform, which has been built into stock prices, is already causing public company valuations to decline.

Competition remains intense in most markets, with increasing pressures for traditional and nontraditional entities. Bankers have been more aggressive in recent years in pursuing prime credit opportunities, compounding the issue. Meanwhile, credit unions continue to make loan and deposit pricing difficult. Bankers also noted that unsecured large installment lenders—including Quicken, Prosper and SoFi—are active in banking markets, which may adversely affect banks' installment lending opportunities. One banker noted that it is impossible to gauge how much business is lost to this latter source of competition, as banks have no way of knowing about deals for which they never had an opportunity to bid.

Nonbank entities competing for control of the payment system are a concern in the long term, some bankers noted. Other important and related topics pertain to the subprime lending market and the potential for a future student loan debt

bubble—with possible implications for future homeownership, consumer lending and retail banking.

Bankers said that the digital disruption taking place in the retail industry, led by behemoths like Amazon, is filtering down to many other industries. They mentioned that they are carefully studying the implications of banking moving from physical to digital platforms, including how their respective banking centers must evolve. Banking used to be based on the notion that “I have to leave my residence and go to a physical place,” one banker said. Now, progressive community bankers are trying to understand and respond to different questions: How should banking centers of the future function? What kinds of activities must take place in branches to attract prospects and retain clients?

Bankers mentioned problems in managing generational differences. By way of comparison, many churches have chosen to manage the generational shift by implementing two services: hymnal and singing with a more traditional service for the older generation, and a second service with a worship band and a more contemporary service to appeal to Gen Xers and millennials.

Industry consolidation also is a concern among Indiana bankers. Public companies continue to face shareholder pressure in terms of stock performance and maintaining adequate access to capital.

While bank managers and board members are not limiting themselves to certain asset-size thresholds when considering expansions or acquisitions, Indiana bankers, in general, see value in greater economies of scale.

Another challenge for bankers is how to replicate a local touch as they expand to other, new markets. A related issue is being able to manage an institution when it reaches an asset size at which bankers no longer know every single customer of the bank.

Regulation and Supervision

Regulation and supervision is generally well-received and appreciated among Indiana bankers, who described strong partnerships with their regulatory authorities. While the regulatory approach and quality of supervision were generally considered strong, bankers noted a few areas that warrant review.

One example was the extended time it takes for banks to receive federal compliance examination findings and formal feedback. One institution noted that its compliance report has been outstanding for over a year, despite agreement on the issues and corresponding ways to fix them. Bankers also characterized some federal compliance decisions as “punitive,” adding that those violations observed to have no harmful intent could be reconsidered.

While, in general, the examination process was said to work well, regulators sometimes ask for duplicate information through the examination process or routine surveys. At times, particularly during federal compliance-related examinations, a lot of upfront information is requested, although it is not clear if the information is used. Bankers also expressed a strong desire for regulators to leverage technology to perform more examination work off-site.

Compliance with the Bank Secrecy Act (BSA) continues to be very time-consuming, as the number of “dead ends” from automated system searches is high. Bankers noted that it would be beneficial to develop a way to limit false positives without triggering regulatory concerns over system risk limits. Likewise, resources spent on gathering, monitoring and reporting on BSA and other compliance items—particularly reporting under the Home Mortgage Disclosure Act (HMDA)—are expansive.

Regulatory policy involving safety and soundness examinations was not mentioned as a significant operational concern;

Indiana *continued*

however, it was noted that pulling back on some of the risk-tightening by regulators during the financial crisis may be warranted in some areas. While regulatory policy and supervisory activities were not considered a major impediment or uncertainty, implementation of the Current Expected Credit Loss (CECL) model is affecting planning strategies.

Small Business Lending

Bankers said that small business lending continues to be the “bread and butter” of community bank lending opportunities. Competition remains the biggest factor in small business lending, as there is a finite volume of quality loans and a significant volume of providers competing for the same loans. Pricing is very low, and some market competitors were said to be willing to loosen traditional underwriting standards, such as requiring guarantors or reducing collateral coverage. Two Indiana bankers indicated that competitors sometimes entice business borrowers with very favorable term sheets and then, through the process, bring the borrowers back to more realistic terms. This puts other financial institutions out of the running. Regulation was not discussed as a primary impediment to small-business lending growth.

Credit unions are becoming more aggressive in certain banking markets, increasing competition. The loosening of National Credit Union Administration (NCUA) lending and field of membership regulations has allowed credit unions to pursue opportunities more broadly. With their built-in pricing advantage, credit unions are often able to offer better terms than can a community bank.

Fair lending regulations impede growth in some cases, bankers noted. For instance, if a bank seeks to make loans to a few select businesses in a particular area, that bank may need to grow its presence significantly in the area, despite a dearth of other

opportunities. Another challenge is a lack of loan officers or underwriters capable of ensuring that proper deals are obtained, analyzed and booked.

Management Structure and Succession Planning

The aging of the industry’s workforce is something bankers are concerned about and proactively consider as they prepare for future changes in management and board leadership. While all of the bankers surveyed discussed a proactive approach to succession planning, they noted that such planning is not always top of mind for many community bankers. Competition for talent is tough, and finding people with experience in skilled areas such as e-services, compliance, information technology, trust and lending is a challenge. Bankers noted that they have been successful in training employees internally. They acknowledge, however, that they must continually look for ways to retain employees while, at the same time, working within the constraints of a smaller institution’s budget. Challenges with succession are one of the key drivers behind consolidation.

An aging shareholder base is another concern. Banks often look for partners due to either management succession issues or shareholder liquidity needs. Succession and leadership development are core focuses for the long-term viability of an organization, according to bankers. The acquisition and retention of quality talent is challenging, as banking has not been a sought-after profession with the current generation and few schools offer specific banking immersion programs. Additionally, the cultural shift of rapid advancement and multiple jobs is an impediment for retention.

Technology

Bankers said that innovations in technology are considered necessary but not without risk or cost. While cyber threats

will always exist, technology can provide an opportunity to level the playing field with many bigger competitors. Bankers noted that technology provides the ability to compete with larger organizations and, in most cases, can make institutions more agile by bringing products to the market faster and more successfully.

Although cost continues to be a factor with the most innovative products, bankers said that expenses associated with many technologies are steadily declining. Partnerships can be formed through technology, benefiting the bank and its customers. One banker indicated that the bank has offered online mortgages through a partnership with Mortgagebot and a banking app from Fiserv. Offering technological tools was said to no longer be a luxury but a necessity to attract new customers and maintain the current customer base.



Iowa

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Iowa bankers are greatly concerned with competition from credit unions and the Farm Credit System, saying that both have unfair advantages in that they pay little or no taxes. And credit unions, although operating under some of the same rules and regulations as banks, are not held to the same standards by their regulators. Lawmakers don't seem to be willing to do anything about it, the banker noted.

Iowa bankers are also concerned about selecting the right core bank system providers and software necessary for their banks to meet the needs and demands of their customers. With only a handful of major providers for the industry, it sometimes seems that these providers don't care about what banks, as their customers, want or need; it is almost a "you're stuck with me" attitude, one banker noted. After a core bank system provider is chosen, bankers said, providers make it difficult to add, and to interface with, desired products and services. They described many "horror stories" about fees assessed when a bank wants to terminate a contract due to a merger or sale.

Another major technological issue on bankers' minds is cybersecurity. Bankers realize this "war" is ongoing and is probably never going away.

Regulation and Supervision

In general, Iowa bankers feel that supervisory processes are not overly burdensome or time-consuming. They appreciate that much of the examination process can be done off-site and do what they can to provide information to examiners electronically.

New and changing regulations are of more concern. These cause delays in providing funding or services to customers and increase costs. The mortgage area, in particular, seems to be the focus of increasing regulation; in this regard, the time it takes to process a mortgage is overly burdened by the number of documents and disclosures that have to be signed or acknowledged. Bankers said mortgage lending needs to be simplified.

A couple of bankers expressed concern that the requirements for reporting under the Home Mortgage Disclosure Act (HMDA) would be expanded to small business lending.

Small Business Lending

Iowa bankers, in general, are content with the small business lending environment, which has very few impediments to providing services to customers. Small business lending is very relational, and borrowers seem to appreciate the relationships they have with their community bankers.

Credit union competition is a threat with respect to small business lending. One bank indicated that it had lost deals recently because of underwriting and looser repayment terms (not rates). Some banks indicated a loosening of underwriting standards by competing banks as well.

Management Structure and Succession Planning

Iowa bankers have a wide range of concerns regarding long-term planning. Succession planning is a topic many bankers are considering. It seems to them that younger people are not interested in either

banking as a career or living in a small community away from larger cities.

Bankers noted that the training needed to understand new rules and regulations can be overwhelming and never-ending. Because entry-level employees often deliver services to customers, it is important that they understand the myriad rules and regulations with which banks are required to comply.

Technology

Iowa bankers generally embrace technology, although some are quicker to adopt new technology than others. Bankers "don't have to be on the leading edge but need to be aware that things are changing and technology can be your friend," one respondent noted. Bankers see innovations in technology as an opportunity to provide most services to their customers.



Kansas

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Kansas bankers reported that they face greater competition from traditional banks than from emerging nonbank competitors. Credit unions were mentioned as competitors for commercial loans within certain banking markets.

Bankers expressed concern with difficulties in growing deposits organically, finding qualified employees in rural markets and maintaining consumer lending in markets characterized by nonbank lending initiatives. Some bankers noted that traditional community banks continue to exert the strongest competitive pressure in commercial lending and core deposit gathering; however, for consumer-oriented services, nontraditional providers are the biggest competitors for certain banks.

While discussing issues facing their communities, some bankers highlighted the need to improve financial literacy. One banker noted that he felt that his market area was excessively reliant on two or three main industries for employment and further highlighted the need to diversify the employment market in order to spur economic growth. In addition, population shifts and/or reductions in rural counties were said to challenge organic growth.

Regulation and Supervision

Bankers said that customer demand, competitive pressures and regulatory developments have influenced the products and services offered in their market areas. They mentioned that they are adjusting new products and/or services to meet new regulatory guidelines and to make sure that their screening approaches match

risk-assessment tools in balancing benefits and risks. They further highlighted the need to proactively make adjustments to accommodate the introduction of new products and/or services.

Bankers said that the pace of regulatory change over the past few years has been challenging. They said it is very difficult to keep apprised of certain changes and to address the additional challenge of training staff and ensuring that software packages are up to date. A few bankers noted that it is not only the smaller community banks that suffer because of these challenges, but also the regulators through “policy to practice” implications.

Regulatory interpretation is a concern. A more sensible approach was recommended in the examination process in order to obtain regulatory advice in advance; nevertheless, with so many changes, many regulators are not familiar with all aspects of each new regulation.

Bankers noted that, at this time, there are no specific processes or examination approaches that they consider to be “out of touch” or that “provide little value.” They expressed positive comments overall concerning their experiences with supervisory matters; in this regard, examinations in recent years have moved to a more risk-focused and streamlined approach, which has been generally viewed as positive.

Bankers recommended increasing the dollar threshold requiring a certified appraisal. The current amount of \$250,000, set in 1994, was said to be outdated, as prices obviously have increased. This amount should adjust periodically to keep pace with the market.

The Community Reinvestment Act (CRA) was described as a burdensome regulation for rural areas and community banks. Some bankers noted that a more targeted enforcement approach to regulation would have advantages. A one-size-fits-all approach was said to be inappropriate for enforcement actions, as many regulations have been motivated by “big bank” failures and/or abuses within larger, more complex institutions. Repercussions have translated into enforcement approaches involving community banks that are, at times, burdensome and often create adverse situations for customers or borrowers. For example, one banker noted that counties are already categorized, for various regulatory purposes, as “rural” and/or “underserved” and wondered if this designation could be used to reduce regulatory burden by customizing approaches for the Ability-to-Repay and Qualified Mortgage rules.

Small Business Lending

Kansas bankers stated that they were experiencing greater loan competition from credit unions and that some out-of-state home mortgage lenders are pursuing aggressive strategies to attract residential and multifamily loan customers. Local credit unions are a strong source of competition, and some bankers noted that those types of institutions are the biggest mortgage loan originators in their markets.

Bankers said that increased examiner scrutiny and regulatory changes have impacted their decisions to deny certain small business loan applications. One

Kansas *continued*

banker noted that the primary items for consideration when making small business loans are credit quality and how regulators will view the loan. With respect to competition from virtual and alternative financial services providers, bankers mentioned that they are not seeing significant competition from online sources. One bank noted that loans to existing small business owners for expansion and updating remain a part of its centralized lending program.

Management Structure and Succession Planning

Bankers mentioned difficulties in attracting and retaining specialty staff—for example, compliance staff. On the other hand, some noted that they have been able to leverage in-house management training programs to promote retention and inspire promotion from within. One banker noted that his biggest challenge is replacing new holding company directors/officers. In essence, a common theme expressed by bankers was developing skills internally. Some bankers have considered sharing services with other banks, primarily to save on costs; however, finding a good fit is an ongoing challenge.

Technology

Bankers expressed concern that outside participants have been progressive in technology investment, whereas smaller banks have lagged. In relation to making significant investments in technology, some bankers noted that, over the past three years, they have changed their core banking

system providers in order to provide additional services to their customers. Those new services include mobile banking via a mobile phone app, real-time posting of transactions to allow more flexibility for debit card use, and an outsourcing of network(s) in hopes of reducing dependence on in-house servers.

One banker said that, although technology costs have increased on an annualized basis, those costs—in comparison to total asset growth—have decreased as the result of a merger. Another bank's goal is to provide better mobile banking options so that it can retain key customers. In relation to “regulatory uncertainty” and how that may play into a bank's decision to update technology, two bankers noted that regulatory requirements have generally caused increased costs in technology to their banks. For example, new residential real estate lending regulations required them to purchase an additional loan document preparation program. Similarly, enhanced and more technologically focused asset/liability management programs also have added costs. Another banker noted that he has migrated to a cloud-based server system through a vendor and that this decision has worked out very well for customers and for the bank in general.



Kentucky

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Bankers in Kentucky expressed disappointment that regulatory relief for community banks has not come to fruition as anticipated after the 2016 presidential election. Regulatory burden, coupled with supervisory practices, remains their biggest concern. Of particular note are statutes and regulations relating to the Home Mortgage Disclosure Act (HMDA), the Integrated Disclosure Rule under the Truth in Lending and Real Estate Settlement Procedures acts (TRID), Qualified Mortgage (QM) rules and potential data collection requirements for small business loans. Bankers stated that the QM rules negatively affect their flexibility to work with customers. While not a current statutory concern, the new requirements for assessing the allowance for loan and lease loss, known as the Current Expected Credit Loss (CECL) model, were said to add to an already burdensome regulatory environment.

Many bankers said they face challenges with employee turnover. They stated that attracting qualified candidates for entry-level positions was a significant problem and that, once hired, employees often left for other jobs or careers within a short time frame. Attracting younger workers to the industry was a particular challenge. A few bankers said there had been almost no turnover in senior management; however, retirements were likely in the near future at the board and senior management level. Succession planning in the intermediate time horizon was challenging ownership, senior management and board members.

One banker expressed concern over high tax rates on small businesses, stating that they were hampering business expansion and hiring. Furthermore, these high rates, combined with increasing interest rates, were seen as having potential effects on payment capacity in the near future.

Relationships with third-party service providers were described as important for providing technological services that are relied on by younger customers and are related to cybersecurity; however, these relationships create cost and integration issues. Bankers are attempting to shorten contract terms to provide future flexibility.

Regulation and Supervision

Bankers expressed concerns over the scope of examinations and compliance examination practices. Nearly all bankers said that compliance examiners focus on finding problems instead of acknowledging improvements or helping them implement best practices. Bankers stated that regulators require banks to engage consultants for compliance reviews, internal audits, external audits, loan reviews, asset/liability management reviews and compliance with the Bank Secrecy Act; however, bankers felt that the results of these numerous reviews did not alter the scope of examinations. The bankers stated that there were no perceived benefits, from a regulatory perspective, derived from the tremendous cost associated with the aforementioned reviews.

The most time-consuming or burdensome process for bankers now is preparing for upcoming changes under the CECL model and the HMDA. An analogy used with respect to compliance examinations described “rules of the game [that] change during the game”; in this regard, bankers feel that they can never adequately prepare for a compliance examination. Although they are confident that safety and soundness concerns have been addressed, they fear upcoming compliance examinations due to the volume of regulations, the substantive changes to the regulations, and the supervisory approach of the compliance examiners. Any compliance issues seem to be elevated to Washington, D.C., for decision, with the usual outcome being

some type of supervisory action against the bank. These actions are crippling to banks due to the length of time for the regulator to remove the action after the issues have been resolved. Furthermore, if any issues are outstanding, the bank is prohibited from growing, establishing new branches or otherwise expanding operations.

Small Business Lending

Impediments to small business lending described by bankers include: minimal small business formation; excessive competition; regulatory scrutiny; and a lack of qualified appraisers in rural, insular communities. Bankers reported that demand for small business loans is modest. Banks in urban communities reported a slight increase in business loans; however, banks in small, or rural, communities have seen little or no increase.

Bankers reported that loans are not being approved for marginal borrowers due to increased examiner scrutiny. They opined that marginal business loans are being classified during examinations. Reportedly, regulators are strictly enforcing guidelines relating to commercial real estate lending and are requiring higher levels of capital, if the bank is close to established guidelines, regardless of underwriting and risk management practices.

Heightened levels of competition are reported due to credit unions, federal agencies such as the Farm Credit System (FCS), and online lenders. Business lending rules for credit unions have recently changed, and banks perceive this as increased competition for business loans. Also, FCS has been aggressive with respect to low rates, extended maturities and favorable terms. Several bankers reported that long-term business customers are obtaining loans via the internet due to speed of approval and lack of collateral requirements; they reported that some customers have been

Kentucky *continued*

able to obtain unsecured loans up to \$50,000 within one to two days of submitting an application.

Banks in urban communities reported no problems in obtaining the services of competent appraisers. Banks in rural, insular communities, on the other hand, reported a general lack of appraisers, particularly those qualified to value commercial real estate. Banks must often engage appraisers outside of their markets, where appraisers have less familiarity. This can result in a protracted loan origination process or a denial due to the low value assigned to the collateral.

Management Structure and Succession Planning

Employees in compliance, information technology (IT) and lending are in high demand and have high marginal costs if replaced. A bank president stated that if current trends continue, there is a high probability that these three roles will demand higher salaries than he and the chief executive officer. Due to the fast pace of change and increased cybersecurity threats, hiring employees with sufficient IT skills is particularly difficult. Although Kentucky banks are continually working to develop and build staff internally, they face a dilemma: If a bank invests in training employees, their new skill sets make them attractive to competing banks.

For some banks, location is a deterrent for new hires and, consequently, bankers are concerned that a lack of experienced staff could result in bank consolidation. Many banks are outsourcing IT oversight for cost-saving measures and, in some cases, are partnering with other banks.

Some bankers reported that, as employees are promoted, a point will be reached in the near future at which no members of the senior management team, or mid-level management, will have been through an economic crisis. In addition to bank

staffing, succession planning at the board level is a challenge. Many banks are family-owned, and board members are approaching mandatory retirement age. Attracting new members is difficult due to the reputational risk the industry has suffered, as well as the legal risk if the bank has trouble.

Technology

Consumers expect all banks, even small banks, to offer a minimum level of products and services. However, the newest application or internet service may be too costly for them to offer, giving larger banks a competitive advantage. Community banks acknowledge that they will not be innovators or leaders in offering financial services through technology platforms; however, they must be a fast follower. Often, vendors or third-party service providers are the only entities to see profits from new technology, and banks frequently offer services at a negative internal rate of return. For some services, banks must have the customer demand in place before the expense for the service can be justified.

Regarding online lending, some banks feel the need to offer this service to remain competitive, while other banks find that customers prefer face-to-face interaction. Many bankers acknowledged that new technology and fintech companies can make banking more efficient and effective, but keeping up with technology is costly. Kentucky bankers expressed concerns about compatibility, integration and technology security.

Finally, bankers stated that technology has the potential to significantly expand the banks' market areas, which creates issues with the Community Reinvestment Act (CRA) and Know Your Customer (KYC) requirements. They said that the CRA should be modernized, and KYC requirements should be adjusted, to accommodate current business practices.



Louisiana

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Louisiana bankers are concerned about an “anti-business” climate that they say the state is experiencing. One banker noted that, while “optimism is greater nationally, there are still too many uncertainties, which prohibits investment.”

On a regional level, southern Louisiana’s downturn in oil is reportedly affecting local banking relationships. Nearly every survey respondent noted the state’s decline in oil and gas as one of the biggest emerging issues. Though some areas have weathered the downturn fairly well, bankers continue to monitor the local oil and gas industry, including changes in crude oil prices.

Bankers expressed concern about competition from fintech companies—one banker specifically noted SoFi—which have risen, in part, because they are not supervised and regulated in the same manner as depository institutions. One banker said that the recent decision by the Office of the Comptroller of the Currency to grant bank charters to fintech firms is cause for concern: “Allowing fintech companies to acquire a bank charter will allow these institutions to grow and become a threat to the economy.”

Respondents also noted that customer demographics are rapidly changing, with a widespread generational migration of customers to larger cities outside of some bank markets. This has led banks to diversify product lines to capture and retain customers.

Regulation and Supervision

Louisiana bankers said that examinations have become disjointed and take longer to complete, perhaps due to personnel issues: “Examiners are less qualified and less capable of providing quick answers to questions during the examination, and field examiners have less discretion and/or authority to make seemingly routine decisions,” one banker said. Another banker noted that the nature of the questions and burdens of proof associated with fair lending

examinations are challenging aspects of the process. Yet another banker said that “the move to more electronic sharing of information and off-site work has helped a lot.”

When it comes to regulatory burden, bankers noted that compliance with the Home Mortgage Disclosure Act (HMDA) is time-consuming and that changes to it in 2018 will require more staff. One banker noted that the overall examination process is efficient, but the “burden is gathering and collecting the data and information along the way.”

Many respondents also expressed concern over impending implementation of the Current Expected Credit Loss (CECL) model and compliance burdens under the Bank Secrecy Act (BSA) and anti-money laundering rules.

Small Business Lending

Bankers said that new regulations related to mortgage lending have complicated the lending process, since many small business owners use their home as a financial resource. One respondent noted that, because of BSA, much time is spent “monitoring small business accounts, which are cash-heavy and often have unsophisticated financial management systems.”

Respondents also noted that many small businesses simply do not have the necessary information to apply for a loan, which creates incentives for them to approach non-traditional lenders and large banks that use credit-scoring models. To address this issue, one bank is “investing in technology that will make it easier to apply, analyze and close small business loans.” Another banker said that small-business loan demand is down because banks have become “stigmatized” as small firms seek alternative forms of funding. Another respondent noted that small business lending is steady, but there are concerns about the extension of HMDA reporting to small business loans.

Louisiana bankers expressed concern over the lack of qualified appraisers for commercial real estate lending activity.

Respondents also noted that the “regulatory perspective” on these loans is too broad and treats all loans similarly, regardless of risk level.

Management Structure and Succession Planning

Louisiana bankers continue to face difficulties in attracting and retaining talent to work in back-office operations, lending and commercial banking. Many respondents noted that it is particularly difficult to attract and retain millennials. For one bank, these challenges lessened when it moved into more heavily populated areas. Yet another bank noted that board succession is an issue, as three of its directors are reaching retirement age.

One banker noted the challenges of serving a multigenerational customer base: “The largest factor impacting long-term planning is deciding who will be your customer in the future and how do you deliver your products to that customer. Presently, our bank, as well as the industry, is attempting to cater to several different generations—baby boomer, Gen X, millennials. Deciding on the different platforms to service these clients is a huge challenge going forward (i.e., building branches vs. developing online lending and payment system platforms).”

Technology

One Louisiana banker shared that investing in technology is a priority and is happening in “mobile banking, online account opening and online applications.” This banker’s institution is conducting much of its data processing through a technology co-op with 45 other institutions. For this institution, technological investment is a priority. Similarly, another banker noted that technology offers an opportunity to compete with larger banks and nonbank lenders. Because of the infrastructure costs of in-house development, many bankers maintain vendor relationships to fulfill technology-related needs.



Massachusetts

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

The Massachusetts economy remains strong and vibrant, with an educated and engaged labor force. An increase in demographic diversification has contributed to a healthy environment for the banking industry. Rural areas and surrounding gateway cities tend to lag in opportunity yet grow economically. Revisions and updates to the state's regulations have led to a streamlined regulatory environment for businesses.

Massachusetts bankers report that diversified, local banking markets in the state remain strong, particularly in areas within commuting proximity to Boston. In these areas, growth in housing and a large talent pool have driven growth in property values, which has spurred an increase in residential mortgage products and commercial real estate (CRE) lending. Banks located in rural areas and near, or in, gateway cities have seen a tightening of competition from both online entities and other community banks.

Regulation and Supervision

Massachusetts bankers identified a competitive market, as small banks must go toe-to-toe with online financial services entities and more traditional competitors like large banks and credit unions. Although community banks are able to provide exceptional service, they are finding that, even with a full set of online banking products, customers have more options when searching for financial products. Other institutions, such as credit unions, also do not have the same regulatory requirements as banks. This can result in more desirable terms and conditions for financial products than banks can provide. Bankers would like to see revisions to the regulations in this area to level the playing field.

Online banking has allowed banks to make loans to broad geographic sections of the population. This has increased bank competition from outside the locale of a given small community bank. Such dispersion also has the potential to distort assessment areas under the Community Reinvestment Act (CRA). In this regard, bankers are concerned about not receiving

adequate CRA credit for loans they buy in their area, as well as for those they originate but then sell. In addition, because of the tight market, banks may engage in collaborative development just outside their area and, yet, not receive CRA credit.

Uncertainty with respect to revisions to laws and regulations continues to concern bankers. Constant adjustment of regulations requires banks to spend time and effort to revise their regulatory processes. Personnel involved in these processes are not revenue generators and, to that extent, limit a bank's ability to remain profitable. Requests for streamlining of schedules and combining of examinations were made by a number of banks. Automated transmission of documents has helped with their preparation for examinations.

Small Business Lending

Community banks face increasing competition from credit unions and online companies. Though many commercial customers remain with the banks because of the personal service they receive, banks are increasingly concerned about credit unions, which operate under different regulatory requirements. In addition, especially in rural areas of the state, banks are not as able to lend on a profitable basis to some small, cash-based commercial customers, thus tightening the market. CRE loans remain a lower risk for most banks, but there has been an increased scrutiny of appraisals, particularly on speculative development.

Community outreach, civic engagement and reinvestment are very important to bankers in Massachusetts. They are committed to customer service, staffing branches and engaging in financial education in the schools. A few banks are exploring various branch models, such as "coffee branches," and sitting offices in historic buildings.

Management Structure and Succession Planning

Acquiring and nurturing talented staff is a priority for community banks in Massachusetts. Bankers in rural areas are feeling the effects of a tightened labor force, as more educated people tend to

move closer to cities. Bankers located in, or near, gateway cities find that a lack of relevant education in their communities restricts their bank's ability to hire qualified staff. These banks also look for recruits who are bilingual and can respond to cultural differences in the population.

Bankers are recognizing the need to train and educate their staff in order to retain talent. They are finding that there is a higher educational standard needed for banking in the current environment. They often look to industry group training programs for recruits.

Mergers have provided pools of talent for banks to draw upon. They also have created new banks with greater human resources (HR) requirements, resulting in collaborative HR efforts. Term limits and aging of boards are constant concerns, as community banks constantly seek to recruit board members from their communities. Board members are viewed as partners who pose credible challenges to management and who know the importance of board education and engagement to a bank's continued success.

Technology

Information technology (IT) is viewed as an opportunity by Massachusetts banks, though it has not changed how banks do business in areas such as underwriting and customer service. It has, however, allowed small banks to broaden their geographic base and provide products to customers who may never enter a branch. Larger community banks have developed in-house IT departments to develop their online presence and contain cybersecurity risk.

Smaller banks are either collaborating in this area or hiring third-party companies. Concerns about large fees, a lack of leverage during contract negotiations and the perception that vendors are only focused on federal regulations remain high. IT departments are not revenue-generating, and while hardware and equipment costs are contained or decreasing, software and cybersecurity costs are increasing. Collaboration with other banks has been discussed, with some banks engaging in these partnerships and others not because of compliance and security concerns.



Mississippi

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Local and regional issues vary among Mississippi banks based on their geographic location, economic drivers and customer bases. One emerging issue prevalent for them, regardless of regional or local characteristics, is fintech. The emergence of fintech is stimulating dialogue and a shift in thinking among community bankers in terms of how they do business and what products and services they offer their customers. While some community bankers have chosen to expand online banking services in an effort to stay relevant in the market, other bankers are contemplating partnering with fintech companies to foster innovation, create efficiencies, generate income and lessen reliance on some third-party relationships.

Regional banks and credit unions continue to be the primary source of competition in many Mississippi communities; however, insurance agencies and land banks are growing as less traditional competitors. Regardless of the source of competition, the impact is the same: a loss of loans and a deterioration of a community bank's customer base.

With fewer than 3 million residents, Mississippi communities are a patchwork of distinct markets, industries and consumer markets. Their economies are driven by wide-ranging interests, including poultry, timber, manufacturing, farming and tourism. Hiring by the poultry, manufacturing and farming industries has resulted in an increase in the Hispanic population in many Mississippi communities and an increase in migrant workers in other parts of the state. Depopulation, on the other hand, appears to be more prevalent in the Mississippi Delta communities.

Depressed economic areas without diverse industries have experienced an

exodus of citizens in search of better job opportunities. These departures have resulted in lower tax bases—thereby increasing property taxes—and an emergence of rental markets. In an effort to combat depopulation and changes in consumer demographics, many community banks are branching into different markets to offset disparities caused by a shrinking customer base and declining loan demand. While branching into other markets offers a solution for some banks, it introduces challenges to others operating in those markets, resulting in further division of the consumer base.

Conversely, Mississippi communities benefiting from tourism experience a different host of issues. One of the five interviewed bankers, in the second-fastest growing city in the state, said growth has impacted taxes, rental rates and home affordability in the community.

Mississippi historically has had the lowest literacy rate in the nation. Because of this, many community bankers want to not only improve financial literacy—through initiatives such as A Banker in Every Classroom—but also provide life skills, such as creating monthly budgets and balancing checkbooks.

Regulation and Supervision

Community bankers are feeling the impact of regulations through current supervisory processes. Specifically, the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act has resulted in an increase in dedicated staff, training costs and leveraged technologies to manage the documents and work flows that are required to maintain compliance. In addition to satisfying current regulations, community bankers are preparing for full implementation of new supervisory

requirements, such as the Current Expected Credit Loss (CECL) model.

Mississippi bankers are well-versed on current regulations and have developed appropriate supervisory processes to ensure compliance. However, some bankers indicated that the fear of regulatory repercussions has influenced the products and services that they choose to offer, and the markets and industries they serve. Fair lending regulations, the Home Mortgage Disclosure Act (HMDA), the Integrated Disclosure Rule under the Truth in Lending and Real Estate Settlement Procedures acts (TRID), and Bank Secrecy Act/anti-money laundering requirements top the list of cumbersome regulations among community bankers.

Unintended consequences of supervision have resulted in an overabundance of information, as well as overlapping regulations, with no material benefit to the consumer. Centralization of some processes is a disadvantage for community banks and is misaligned with the concept of community banking. One banker identified a thin line between adopting regulatory bank practices and maintaining the community bank culture.

Mississippi community bankers were not hesitant when offering possible solutions for regulatory relief for their banks. One resounding recommendation was for lawmakers to talk with bankers before crafting regulations.

While bankers didn't indicate a need for more modernized bank supervision, they did say they wanted to see regulators better utilize technology in both on- and off-site supervisory processes. They also anticipated that greater efficiencies could be created by conducting off-site examinations.

Mississippi *continued*

Small Business Lending

No significant impediments to making small business and commercial real estate loans were noted; however, low loan demand has negatively impacted lending in economically depressed rural areas. Competition in many communities remains relatively unchanged, with credit unions and regional banks serving as primary competitors. The market share of the consumer business held by community banks is further diluted by the presence of nondepository entities, such as online lenders, finance companies and check cashers.

While tighter credit standards, perceived increases in examiner scrutiny, regulatory changes, regulatory uncertainty and the actions of the new presidential administration may not, necessarily, impact small business loan approvals, they play a key role in how community bankers conduct business.

Management Structure and Succession Planning

Bankers reported that community banks located in, or adjacent to, metropolitan areas have not experienced much difficulty in attracting and retaining specialty staff, such as for compliance, but banks in rural areas have. It is more difficult for them to entice qualified individuals to move to rural areas with depressed economies, substandard school systems and limitations on, for instance, city services. To combat this challenge, bankers are cross-training current staff and have shifted their mindset when hiring. Instead of hiring to fill a specific position, they now hire to fill multiple positions, with room to train and grow within

the bank. By developing current staff and promoting from within the bank, bankers are fortifying management succession.

Many community bankers said they have experienced high turnover in the area of compliance, as well as some front-line operations, such as the teller function. Bankers directly attributed this turnover to a “law enforcement role,” regulatory expectations and related liabilities. Many worry that high turnover will threaten the sustainability of the community bank culture.

Technology

As community bankers search for ways to create efficiencies, their reliance on technology is increasing. They continue to make investments in their system infrastructure to create efficiencies, meet expectations of younger generations and maintain effective compliance systems.

Regulatory uncertainty plays a role in the decision-making process of every banker. While generally progressive, community bankers are taking a measured approach when making advancements in technology. Some expressed concerns with the capacity of vendors to keep pace with regulatory guidance for CECL models, software development, implementation gaps and effective dates of regulatory enforcement.

There is little indication that community bankers are contemplating changes in third-party relationships. Many of them expressed concern about their increased reliance on third-party providers, as well as the supervisory expectations related to vendor management oversight.



Missouri

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Competition in relation to local mergers and acquisitions is a concern to Missouri bankers. They are focused on finding opportunities for high-quality growth; bankers said that finding the right asset size for peak efficiency is an often-vetted topic among managers and board members. Identifying the “sweet spot” and how to get there is a topical issue—that is, whether through acquisition or organic growth.

A banker near the St. Louis market is starting to see some competition for small business loans and commercial lending from credit unions. This was attributed to slow demand for consumer loans; if expanded lending powers are granted to credit unions, they will be an even bigger threat to banks.

One banker was worried about his area’s longer-term job forecast, as “most high-paying jobs are moving or are concentrated in urban areas.” Correspondingly, local students who pursue higher education elsewhere (or out of state) often do not return to their local communities, which further strains the employment market. Another banker noted that people who’ve been out of the labor market for a long time are more vulnerable to drug use.

Regulation and Supervision

One banker, noting that the supervisory process is not very burdensome, was grateful for the 18-month examination cycle. Probably the most burdensome supervisory processes were said to be on the compliance side in regard to the mortgage industry; as a result of these regulatory requirements, one bank no longer offers these types of products. Its management also feels as though it is unable to meet the needs of the community. It would like to see similar regulatory requirements for credit unions in order to level the playing field.

Bankers are challenged by compliance burdens for consumer real estate loans imposed under Ability-to-Repay and Qualified Mortgage rules and the Dodd-Frank Wall Street Reform and Consumer Protection Act. In addition, the foreclosure process was said to be troublesome and costly, particularly the extended time frames on 1-4 family homes. The lengthy foreclosure process also has created much greater losses on these loans, as homes must sit vacant and in disrepair for three to four months longer than before. Expansion of required information under the Home Mortgage Disclosure Act (HMDA) is time-consuming and unnecessary, at least for smaller institutions. Some of the newer rules from the Consumer Financial Protection Bureau on military personnel are excessive, one banker noted.

Small Business Lending

Bankers are seeing few impediments to small business loans. The adoption of fintech is fairly limited in certain banking markets, some bankers noted, with one stating that he had not made any material changes to underwriting or approval processes. He also said he has applied for grants through the Community Development Financial Institutions Fund in order to increase his focus and attention on small business lending.

Management Structure and Succession Planning

One banker noted that his institution is in a unique position, as its president and chief executive officer is the only member of the senior management team who is over 35 years of age. This bank was said to have benefited from being relatively close to a larger metropolitan area, which has helped it recruit qualified employees. Another banker noted that he is able to retain

employees by offering stock options and ownership opportunities that are unavailable at most rural, family-run banks. Other bankers agreed that qualified employees are hard to find in rural markets.

As community banks continue to consolidate, one banker acknowledged struggling with bigger competitors to attract employees. That banker noted that the only answer may be to grow in order to compete, although achieving that growth—in a market with increasing competition—is difficult.

Technology

Bankers, for the most part, view changes in technology as an opportunity. Despite the initial time and expense to implement the technological changes, bankers said that these changes will improve efficiencies in the long run. In this regard, technology was said to be taking over some manual processes that, in the past, required multiple employees to handle. The need to fill vacancies in back-office work will start to decline in the future.

On the other hand, the cost to keep up with changing regulations and requirements for technology/software is considered a threat, especially to smaller institutions—for instance, the software needed to meet requirements for the Current Expected Credit Loss (CECL) model. One banker noted that new technology is great, but it adds extra layers of risk from the perspective of phishing and/or hacking.



Montana

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Montana bankers mentioned that the most significant local, regional and national concerns to their institutions were centered on commodity prices in both the energy and agricultural sectors. These economic sectors are facing depressed commodity prices that are filtering into other areas of the economy, some bankers said. This is especially concerning, given that the eastern part of Montana is experiencing the most severe drought in its recorded history.

From a banking perspective, this is causing credit quality to decrease and liquidity to tighten. Concerns expressed from bankers include “regulatory overreaction” to the natural cycles of agriculture and concerns about the general survival of agricultural banks going forward. Some bankers noted that, if regulators approach the agricultural downturn in the same way they approached the recent commercial real estate challenges, misaligned supervisory approaches can occur.

Regulation and Supervision

Some bankers embrace attempts to perform more of the examination processes remotely, while others find this to

be more burdensome. Bankers continue to be concerned about changing regulations and inconsistencies in regulatory interpretations. Some are still worried about complying with the Current Expected Credit Loss (CECL) model and are increasingly concerned about the potential expansion of fair lending rules to small businesses (that is, Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act).

Bankers are desperate for, and hopeful that, consumer compliance examinations can be made more like safety and soundness examinations. They seek an examination that will help them comply, without penalty for minor deviations or errors.

Small Business Lending

Montana’s bankers said that the majority of competition in small business lending comes from other local or regional financial institutions, as well as from the Farm Credit System. Increasing competition from nontraditional lenders was also noted. The primary challenges in small-business lending decisions are centered on increasing concentration risks and regulatory scrutiny around those parameters.

Management Structure and Succession Planning

Attracting, training and maintaining qualified employees are always issues in rural communities, bankers noted. Shared services have been considered, but such strategies have not been adopted by many banks. With that said, some of the smallest banks in Montana have merged in order to create economies of scale for those that still provide physical branches in a number of small communities.

Technology

The smallest banks in Montana (assets under \$100 million) generally consider technology to be more of a challenge than an opportunity. Midsize and larger banks are beginning to embrace new technologies to expand their footprints and to provide better products and services to customers.



Nebraska

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Nebraska bankers are concerned primarily with economic stability, particularly in the agricultural sector. Sustainable housing's impact on the local community was also mentioned as a concern, along with the stringency of regulations on home loans. Two bankers expressed concerns regarding the impact of the Current Expected Credit Loss (CECL) model, particularly in a down market.

Three bankers identified a need for increased financial education. They said customers need to understand the risks associated with giving up control of their financial information. Uncertainty surrounding the Dodd-Frank Wall Street Reform and Consumer Protection Act and competition from nonbanks were other important topics mentioned by bankers.

Regulation and Supervision

Nebraska bankers uniformly described compliance as a costly and time-consuming requirement. A majority of them reported increasing compliance costs associated with the Home Mortgage Disclosure Act and the Integrated Disclosure Rule under the Truth in Lending and Real Estate Settlement Procedures acts. One banker suggested that regulators could share information between examination types, without having banks submit multiple copies to multiple examiners. One banker expressed concerns that interactions between bankers and examiners may diminish if too much of the examination process moves off-site. Another indicated that safety and soundness examinations are generally helpful and not overly burdensome.

Small Business Lending

Two bankers indicated that competition is intense, especially for small business startup loans. One banker believes that other competitors are willing to make unprofitable deals to get the loans. Bankers expressed concerns regarding the potential for increased tracking of information under customer identification programs. One banker said that regulations and the related volumes of paper they create are counterproductive and confusing to loan customers.

Management Structure and Succession Planning

The availability of labor and, more specifically, the ability to find someone willing to learn banking, were reported as problematic by bankers. The task of recruiting and retaining skilled labor is a challenge in both small and large communities. Only one banker, who was part of a management group that is five years from retirement, did not identify current labor concerns.

A majority of bankers mentioned that skilled employees in information technology (IT), general banking and banking compliance are in demand. One banker described challenges with recent hires seeking rapid advancement, a wide range of judgment and limited accountability. Another banker noted an increase in spending on IT and a decrease in future branching-related spending. Others referenced changes in core processing, mechanisms for working bank data, and control points for software and database applications. One banker said that, unlike

other bank budget planning, IT plans are more time-sensitive. Several bankers said that reputational risk and confidentiality are critical considerations.

Technology

All bankers provided examples of technological innovation and associated complications. Two bankers conveyed that more technology creates more costs. One stated that innovation will be good for the bank, insofar as it enhances customer service. With regard to IT costs, opinions were split. One banker said that costs will go up, while another said that technological innovation, by changing delivery and control processes, will push costs down. Universally, bankers believe that banking, and banking partners, will change due to technology.



New Mexico

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

One banker in New Mexico said that nothing in his community has really changed over time: “Business is slow, not many startups in this area.” This same banker mentioned that he had to change his third-party loan processor in order to accommodate the new Integrated Disclosure Rule under the Truth in Lending and Real Estate Settlement Procedures acts (TRID). “It was a costly and time-consuming implementation—it was an expense that we had not budgeted for; therefore, we had to forgo other budget items in order to accommodate this unexpected expense.”

Bankers stated that credit unions are quickly becoming more competitive in commercial real estate loan offerings. The lack of a “level playing field” in terms of regulation, taxation, and lending terms and conditions makes it a challenge to compete with them. One banker noted that he can’t blame the customers whom those competitors attract—who smartly take advantage of relaxed terms and long, fixed loan rates. Additionally, internet-based lenders are impacting certain markets in the state. An example would be Live Oak Bank, which has offerings through the Small Business Administration.

Another banker noted that he’d like to see more relief on compliance regulation for community banks. One area of attention should revolve around relief under the Home Mortgage Disclosure Act (HMDA) for “low-volume” community banks.

Some bankers noted that economic activities within their markets are relatively

stagnant, while one banker indicated that the state was not competitive when it comes to attracting new out-of-state businesses, in comparison to Arizona, Colorado and Texas.

One banker stated that the overall job pool is weak, as he encounters many new entrants to the workforce. Although some offer to work and learn the “business of banking,” most lack basic computing and business knowledge. While the local schools teach keyboarding from a young age, the educational system needs to expand and include spreadsheets and Microsoft Word documents. In addition, most candidates lack basic writing skills, with many unable to produce even a basic business letter.

Regulation and Supervision

Bankers said TRID rules have been difficult to manage, as they have significantly extended loan closing dates. A lack of appraisers has also made real estate lending difficult. The upcoming Bank Secrecy Act’s “expanded customer due diligence-beneficial owner” change is poised to add burdens in capturing data required under the Customer Information Program (CIP). Staff at the bank using manual CIP forms foresee the number of forms doubling, as this regulation affects all new accounts and new loans—not just new customers as before.

One banker noted that the list of rural and underserved communities is not a true picture of his local economy. Changes need to be made reflecting the individual counties on a standalone basis exclusive

of conditions in bordering counties, for example. “This would be beneficial to all,” he said. This banker also noted that examinations are both beneficial and helpful to banking processes and help with maintaining good management practices.

One banker noted that the regulatory approach concerning consumer and fair lending has migrated to a place where bankers must now prove that they are not discriminating when it comes to extending credit or offering financial services. Section 1071 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, requiring expanded HMDA data collection for business loans, is extremely concerning.

The Current Expected Credit Loss (CECL) model is a waste of time and effort for community banks, one banker noted. “We simply do not have enough loans in any one category to create any type of vintage analysis that would be of any benefit,” he stated. “The accounting laws do not allow for a forward-looking allowance for loan losses.”

Small Business Lending

“The majority of the competition in small business lending comes from credit unions out of Albuquerque,” one banker said. They are entering business lending and offering unique terms and rates that are not usually offered by banks. Competition from local sources doesn’t seem to be as prevalent as competition from other types of lenders, another banker noted. Lack of demand is also a factor affecting small business lending, along with tighter credit standards.

New Mexico *continued*

Management Structure and Succession Planning

“One of our top issues is succession planning,” one banker stated. The bank has been working on this issue for several years now, he said. In regard to difficulties in retraining staff or attracting and/or retaining specialty staff, one banker noted that the talent pool for certain specialties is dwindling.

One bank’s expenses have increased threefold due to adhering to the new compliance regulations and continued education and training requirements. This has hindered one banker’s ability to pay the larger salaries demanded by qualified applicants.

Technology

Innovations are considered to be a threat if the innovators are not held to the same banking laws and regulations—for example, customer privacy—as community banks, one banker noted. Technology is considered to be both a threat and an opportunity. Threats, such as cyberattacks, require more monitoring and advanced software to detect, up-to-date equipment able to be used with advanced software, and knowledgeable information technology personnel, one banker noted.

Employees must be aware of threats and need to be trained on how to proceed. Meeting the needs of the younger, technology-minded generation is an opportunity to attract new accounts. These customers are the future of business and must be assured that we can meet

their needs and earn their loyalty, another banker noted. Regarding significant investments made in technology, one banker noted that the bank has implemented automated teller machines to accept cash and have check deposit capabilities. This has allowed the bank to cut branch hours and save on salaries to assist in covering ever-increasing compliance costs.



North Carolina

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

North Carolina bankers said that yield curves must improve. They noted that long-term rates are still under pressure and that sophisticated borrowers are unwilling to take loans at higher rates.

Mergers and acquisitions were viewed as opportunities, with one institution reporting 30 percent growth over each of the past three years—and on pace to do so again this year. Bankers mentioned that borrowers are concerned that acquisitions from super regional institutions may reduce local decision-making authority over lending. They also mentioned that some customers are shifting to locally owned institutions, as larger institutions can alienate customers with cumbersome processes.

Competition for business loans from credit unions remains an ongoing and worsening concern. If credit unions are providing business banking services in direct competition with tax-paying entities, bankers said, then banks and credit unions ought to face the same tax structure. Otherwise, the state and federal credit union regulators should prohibit business lending or, at least, limit its expansion.

Other matters of concern included the ongoing relevance of a mutual thrift charter which focuses primarily on real estate lending. Bankers noted that other lenders are offering “no-doc,” 100 percent financing options with no appraisal. Likewise, competition from nonbank lenders (e.g., mortgage bankers and credit unions) is steep; as a result, there is too much money chasing too few deals. Bankers described a recent race to the bottom when it comes to pricing, covenant-light lending and poor underwriting in both residential and commercial lending.

Appraisals are also becoming a concern, as appraisers from outside the local market are overvaluing properties for other lenders, leading to additional competitive pressure.

At least one banker expressed concern about remaining independent given the increasing pace of merger and acquisition activity in North Carolina. Differentiation among banks is also increasingly difficult to achieve, as is turning a profit from interest revenue. Growing interest income over the next 10 years will become even more difficult as larger banking organizations enter from out of state. Income diversification will be even more important in the future from sources including insurance, lending under the Small Business Administration, and mortgage lending.

Cybersecurity and aging community membership are challenging North Carolina’s bankers. Pressure to retain older customers while recruiting younger ones through mobile and online channels was said to be “tricky” from an expense standpoint. One unique challenge for rural banks in North Carolina is access to infrastructure needed to attract younger residents who want to commute to larger urban areas but live in rural communities. Access to adequate banking personnel also remains a concern, particularly as consolidation continues.

Politics and consistency from Washington, D.C., are seen as essential to the prosperity of community banks. More deregulation would be welcome but is unexpected. The increasing regulatory environment has only added to costs in the form of salary expense for compliance counsel and employees under the Bank Secrecy Act (BSA), without any corresponding increase in revenues for the bank.

Uncertainty in demographics is also becoming an issue, with school enrollments declining year-over-year either permanently or as a result of natural disaster.

Regulation and Supervision

North Carolina bankers had very few complaints about supervisory processes for the past several years. The 18-month examination cycle is a boon for some of them; that is enough time, they said, to ensure that nothing goes seriously wrong but also provides enough breathing room to operate the bank between examinations. Similarly, regulations under the Dodd-Frank Wall Street Reform and Consumer Protection Act are not considered a serious problem because banks already have established regulatory compliance programs. Bankers feel adequately prepared to continue compliance in the future. Finally, the Federal Deposit Insurance Corp. (FDIC) has succeeded in giving appropriate and straightforward advice on interest rate sensitivity that has led to improvements.

Nonetheless, consistency on specialty examinations between federal and state examiners has been a problem. For example, bankers said the state will focus on one component of cybersecurity, and the FDIC will focus on another, leaving bankers with doubts about appropriate prioritization and compliance. Similarly, consistency across personnel has been a problem.

Some banks find benefits in on-site examinations insofar as they afford an opportunity for dialogue and discussion. Remote-only examinations result in limited interactions and findings, without allowing for any rationale or explanation from the bankers.

North Carolina *continued*

The 18-month cycle is too frequent in the opinion of some other bankers. They said the 18-month clock should not start until the “ROE” is signed and delivered. One institution, with only 10 employees, felt that it was constantly under examination or audit.

Similarly, documentation requirements continue to increase. Bankers noted that examiners seem to care less about whether the bank has made a good loan and more about whether the banker has made a good loan file. Bankers are expending a lot of energy keeping up with documentation, which detracts from the core business of marketing and lending.

Other process concerns include compliance with the Current Expected Credit Loss (CECL) model, fair lending paralysis, guidance applied as a regulatory requirement and a “lack of common sense” among examiners. With fair lending analysis, intent no longer seems relevant, particularly with “disparate impact” claims. The uncertainty concerning the standard to be applied in fair lending discourages banks from extending service areas. A greater reliance on statistical analysis, bankers said, diminishes flexibility in pattern and practice referrals.

Finally, bankers said that examiners need to be trained to exercise good judgment and approach the examination process as iterative. The leadership at the federal banking agencies must encourage good judgment and logical analysis.

Bankers cited an abundance of audits across multiple areas that impede banks from focusing on core activities. Audit areas include third-party loan review, internal controls, BSA, information technology

audit and financial review; and, while all of the auditors access the same files, rarely do they leave the files in their original condition or rely on each other’s work. Moreover, the auditors and examiners generally report the same things, leaving doubts about the value of each independent review.

With respect to compliance examinations, responsiveness and accuracy of examiners were said to be a problem. One banker reported receiving an “ROE,” providing a response and then receiving feedback that every other page of the response was absent. After roughly six weeks of discussions, the banker learned that the examiner had only scanned the front sides of each page of the response. Because this was a compliance examination, the banker was fearful of a larger problem when, in reality, it was only a technical glitch.

Examinations are time-consuming, particularly when the on-site portion duplicates much of the work ostensibly assembled during the off-site portion. Examiners must be trained to fully leverage off-site analysis and prepare for limited periods of time on-site at the bank.

Applications continue to move slowly, especially through the federal banking agencies. Likewise, the federal banking agencies do not appear to spend time understanding the local markets, leading to illogical results. In one instance, a banker was told to focus more clearly on ratio lending to consumers but, when that resulted in additional declined applications, the banker was criticized for moving away from relationship lending.

Small Business Lending

Bankers said most impediments are self-imposed, such as structuring credits to focus on hard collateral. They said other lenders are reaching out further on the yield curve, taking on more risk and making 10-year, fixed-rate loans, which is perceived as unfair competition.

Commercial real estate lending is declining in rural markets in North Carolina as a result of pricing rather than regulation. One banker wants to report small business loan data as an outlet to demonstrate good behavior and quality lending policies.

Appraisers are not especially in short supply in many North Carolina communities, but the profession, as a whole, is aging and failing to train younger members at a time when the need for appraisals is increasing. Appraisal turnaround is typically very long, and the cost is high. Appraiser shortages are, however, becoming an issue for rural banks, with 60 percent of licensed appraisers in the state being over the age of 65. Some counties have only a single qualified appraiser, which forces bankers to work around that person’s schedule if he or she leaves for vacation or gets ill.

Rates across the market are very, very low and the costs of documenting and underwriting loans are very, very high. For the loans that are available, community banks need relief from “ADC” guidance or to at least have an opportunity to vary from the guidance if they use sound policies and procedures. The federal banking agencies should have a greater respect for relationship lending and allow some latitude for bankers to demonstrate that they have adequately assessed customers.

North Carolina *continued*

Pricing, terms and structure remain impediments, as are appraisal requirements. For low loan-to-value loans, bankers should be permitted to incorporate tax valuations in their assessment of collateral. Small business customers are also demanding increased fintech accessibility through such things as automated clearing house transactions at merchant locations. Smaller institutions find it difficult to compete with larger players that have dedicated fintech departments.

Many citizens in eastern parts of the state are renters, leaving most of the lending markets to nonowner-occupied real estate. Bankers report difficulty in knowing whether to make necessary regulatory disclosures or forgo lending altogether.

Management Structure and Succession Planning

Long-term planning is going well, but legal uncertainty remains in key areas of bank regulation. Specifically, CECL seems to be in doubt, which threatens the viability of compliance efforts. To the extent that CECL is ultimately implemented, the inputs required for it are opaque, and the utility of the calculation is dubious.

Similarly, legal uncertainty about legislative initiatives in Congress (e.g., the Financial CHOICE Act) are concerning. Community banks are staring irrelevance in the face as a result of the pace of technological innovation and the growing expectations of even small-town customers.

Long-term planning is impacted by avoidance of “trendy” banking options. Although rural bankers don’t want to be on the cutting edge of internet banking, they

want to remain relevant. Some bankers are concerned about expanding their market via loan participations but are now facing concentration risk.

Long-term planning is impeded by day-to-day survival while maximizing shareholder value and turning a profit. Overhead costs continue to increase, and audit expenses have increased tremendously over the past five to 10 years.

Technology

Bankers indicated that technology enables, rather than hinders, business operations. With most back-office, technology-intensive functions outsourced to a major financial vendor, risk becomes a focus. These risks include data theft, social engineering issues and debit card fraud, with the latter leading to an overprotective and potentially burdensome debit card environment. Although technology is not a main driver of customer business for some branches, some customers expect a fully online experience. Banks also provide laptops to employees to enable a mobile work environment, and that seems to facilitate business generation.

Technology was said to be more of a threat than an opportunity along multiple vectors: pace of change, funding to innovate and expense propositions. Small banks are not going to innovate directly; only larger institutions have the capability, funding and time to manage direct innovation. Nonetheless, the customer base of smaller institutions expects the same degree of innovation from a small bank that would more quickly be deployed by larger institutions.

Community bankers must reclaim the mantle of leadership that they once had, which may limit the impact of technology on the core business model. To do this, bankers said, they will need to focus on younger customers and offer valuable educational services to attract and retain those customers.

Bankers report long delays, a year or more, in gaining familiarity with technology. Technological solutions, moreover, typically come with a Pandora’s box of cybersecurity threats. Institutions lack the localized knowledge and manpower resources to combat international cyber threats. To assist in the rollout of fintech services, technology providers should also be regulated, or at least vetted, through an industry trade association.



Ohio

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Emerging issues include online banks, internet-based mortgage lenders and online deposits. Competition continues from the Farm Credit System, as well as from the credit union industry. Bankers expressed concerns about new Home Mortgage Disclosure Act (HMDA) reporting requirements, which could result in additional staffing and software resources necessary to meet them.

Merchants, especially Walmart, are forcing consumers to choose debit cards instead of credit cards, one banker noted. Debit card fraud continues to be an issue, as are delays by some companies (e.g., Kmart) in announcing fraud.

The opioid epidemic is affecting all parts of the community, including the rural areas, and is draining police and fire resources, as well as the health care system.

Payment systems, such as Venmo and Stripe, are popular with a younger demographic. With a changing customer base, banks are concerned with how to attract younger customers, especially in view of their aging depositors (older than 65) and an aging population in general. Use of a national registry for certificates of deposit is being explored. Loan-to-deposit ratios are becoming more of a concern. Auto sales are dropping but, on the other hand, unemployment is also at a lower level. Concerns about retail store closings persist.

Regulation and Supervision

Ohio bankers said that pre-request lists for bank examinations need to be more focused and that additional lead time should be provided. Even with recent modernizations, preparation time for required financial reports has not been reduced, some bankers noted. With regard to vendor management, the examination information provided by the federal banking agencies is very general and may not provide much benefit, especially since it is a requirement for board-level review. Use of examination software is “hitting the mark,” meaning examiners are requesting and reviewing the loans that are of most concern to bank management. Off-site loan review is viewed as positive and helpful.

Small Business Lending

Commercial real estate lending in Ohio is very competitive in terms of pricing, credit terms and service. Small business lending is becoming more automated. Concerns regarding fintech are growing; how do banks compete with, or mitigate the risks of, fintech firms? Aggressive pricing under market rates from large regional banks continues to be a challenge for community banks.

Management Structure and Succession Planning

Ohio bankers said the current regulatory environment has commoditized banking. They also said that resistance to innovation within the community banking industry could result in further regulatory scrutiny.

Trust activities are growth areas, but concerns were expressed with respect to “1-800-ROBO” wealth management advisors that are active in the marketplace. Operating digitally is said to be an increasing risk, along with a lack of sufficient resources for effective management. Similarly, long-term planning is hampered by the inability to attract and retain employees at community banks; a particular concern is getting college students to return to their hometown for employment. Employee involvement in the communities was said to help promote a feeling of involvement and ownership.

Technology

Technology was described as both an opportunity and a challenge. Social media channels are an easy way to “get the word out” on banks and banking products. As noted before, online mortgage lending and deposits are increasing dramatically. Keeping up with this requires upgrades in technology, social media, websites and the technical expertise necessary to operate in this electronic arena.



Oregon

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Oregon bankers, who represent a cross section of banks ranging in size from under \$100 million to slightly over \$350 million, said that the state economy has been doing quite well in recent years. Job creation has been strong; despite significant in-migration, the unemployment rate has dropped to 3.6 percent (May 2017). Residential and commercial real estate prices have risen well above pre-crisis levels.

Despite the healthy economy, the state is experiencing budget challenges, partly due to a large and growing liability associated with public employee pensions, which limits the funds available for transportation and other infrastructure projects, education, etc. Bankers are concerned about proposals to increase corporate tax rates because of the impact an increase would have on the businesses that are the banks' customers. Bankers also are concerned that these budget woes are occurring at a time when the economy is doing well; what, they ask, might happen if economic growth slows or turns negative?

Smaller communities, and banks located in them, are seeing the labor pool shrink as younger people migrate to larger cities, particularly Portland. As a result, banks located in urban areas have less of a challenge finding employees.

None of the bankers surveyed indicated that they were experiencing heavy competition from fintech companies. Nor did they express significant concern about the potential for future competition from them because they feel their target customers differ. However, bankers said credit unions are making significant inroads into small business lending, an area that has traditionally been the domain of community banks (even though the credit union share of such business is relatively low). Large banks have lowered the minimum sizes of business loans and are offering rates and terms that community banks often have trouble meeting.

Bankers universally expressed concern about the financial illiteracy of 19- to 25-year-olds; one example cited was the inability of young people to balance their bank statements. Several banks are exploring ways to partner with schools, high schools in particular, to provide financial education for students. Bankers said millennials, in general, do not seem to know much about community banks and what they do. And most millennials do not have any interest in banking careers, partly due to a generally negative perception about banks, further limiting the availability of new employees for the industry.

Regulation and Supervision

Oregon bankers said that the supervisory process was not overly burdensome, especially under the 18-month examination cycle for banks with assets under \$1 billion. They felt that the examination process has improved noticeably in recent years, with better communication between examiners and bankers and with examiners being more fair and reasonable with their examination conclusions, findings, recommendations and ratings; examiners are not so driven to "find stuff" as they used to be. The bankers value the supervisory process and view examinations as an important way to ensure that internal controls and systems are working effectively and that their banks are operating in compliance with laws and regulations. In particular, they said they receive considerable value from the information technology (IT) examination.

Some banks have elected to stop making mortgage loans entirely due to the expanded compliance requirements. However, rural banks feel compelled to make mortgage loans as a service to local residents despite the increased regulations (many of which the bankers view as unnecessary and burdensome). One banker asked, "If we don't offer these products and services, who will?"

Small Business Lending

Loan demand in Oregon has been quite strong the last couple of years, and most banks have seen healthy increases in loan levels. Banks continue to be in a good position to lend, as they have adequate capital and the liquidity.

Commercial real estate (CRE) concentration levels have grown, but they remain below pre-crisis levels, particularly for construction lending. Continued close regulatory scrutiny may be causing bankers to limit lending; similarly, a potential "overheating" of the real estate market has caused them to tighten CRE underwriting standards. For Oregon's smaller institutions, with smaller capital bases, concentrations and loans to borrower limitations remain an impediment to lending.

Loan demand was said to be strong enough to have improved pricing. This contrasts with conditions two or three years ago, when loan demand was still relatively weak and community banks often were losing deals because of an inability to compete on price or terms with some of the larger regional and national banks. That situation has dissipated to a large extent, although local credit unions are now providing stiff competition in some markets.

Oregon community banks tend to focus on "finding solutions" when working in partnership with borrowers or prospective borrowers. Underwriting standards and the credit culture of Oregon banks have not changed materially over the past three to five years, although some moderate and appropriate tightening has occurred in CRE lending. With respect to small business loans, bankers indicated that, in general, underwriting decisions made during the last year would be no different than the decisions that would have been made in the years just prior to that; a loan that was approved then would be approved today, and a loan that was declined then would be declined today.

Oregon *continued*

Management Structure and Succession Planning

Bankers said that staffing is an issue in long-term planning. In recent years, despite ongoing industry consolidation, it has been difficult for banks to fill positions with qualified individuals, particularly at banks that are not located in or close to major cities. The problem is even more acute in specialty areas such as Bank Secrecy Act (BSA) compliance and IT. Executives and experienced lenders also are hard to hire. One institution is projecting a turnover of its entire lending corps within the next six years due to retirements; it expects difficulties in replacing them. Even with the recent consolidation of banks, qualified lenders remain scarce. Banks are increasingly developing staff internally for positions such as those in BSA and consumer compliance. The availability of appropriate personnel, or the lack of it, impacts the ability to grow and to offer products and services that consumers and businesses demand in a rapidly changing banking environment.

For some of Oregon's smaller institutions, access to capital has been challenging, which has consequently limited their ability to grow. Conversely, larger institutions indicated that capital was readily available.

Generating a sufficient and sustainable level of profitability remains a challenge for some banks, primarily due to margin pressures. In an effort to improve the bottom line through cost reduction, banks have been considering sharing services with other institutions; however, nothing along those lines is being done presently on any meaningful scale.

Technology

Oregon bankers see technological innovation as an opportunity while also realizing that they do not have much choice but to adapt to it. They recognize that in order to remain competitive, especially with the emerging millennial customers, they must be receptive to technological changes and be willing to offer products and services that customers expect from their financial institution. One banker stated, "Millennials do not understand the concept of a community bank; they will bank wherever the technology works best."

Technological innovations are viewed as an opportunity for banks to expand their footprint without having to build brick-and-mortar branches. Technology is allowing banks to reach customers who may be 30 to 50 miles away from a traditional branch, which is particularly beneficial for banks located in the rural and coastal areas, as well as for smaller institutions.

Nevertheless, bankers expressed reluctance to adopt technologies that are on the cutting edge of innovation and indicated that they would prefer to be in the second wave of adopters, after the technology has been sufficiently tried and tested by others. At the same time, the bankers all appeared to recognize the need to stay on top of technological changes and be nimble in reacting to it, more so than in the past when the pace of such change was much slower than it is now.

Bankers do not feel that technology costs for their banks are decreasing, particularly because the increasing use of technology and heightened security concerns require more staff in the IT area. Investments in core systems are being made incrementally, generally by purchasing add-on packages offered by vendors. Regulatory uncertainty is not particularly an issue affecting decisions around investments in technology.



South Dakota

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

The primary economic driver in South Dakota is agriculture, and commodity prices remain low for the third year in a row. As a result, cash flows remain tight and the impact on operators is becoming more pronounced. An emerging concern this year is widespread drought in South Dakota. With the exception of the southeast corner of the state, most of South Dakota is in some degree of drought. South Dakota community bankers said that the overall regulatory environment at the federal level continues to be a challenge. They see little in the way of tangible progress to reduce the cost and burden related to the Integrated Disclosure Rule under the Truth in Lending and Real Estate Settlement Procedures acts (TRID), the Home Mortgage Disclosure Act (HMDA), rural home lending, Basel III and appraisal thresholds and mandates.

Other concerns include rural depopulation, which is impacting rural businesses, including banks, and their ability to recruit employees and capital; a consolidation among agriculture operators, which has increased their size relative to community bank lending limits; affordable housing, particularly in rural areas; increasing competition from fintech companies; pronounced competition from other banks and increasingly from credit unions; and lost ground of community banks in consumer lending as more options become available to consumers (even before banks have an opportunity to interact with them).

Regulation and Supervision

Overall, the burden associated with the compliance examination process has been substantially reduced over the past several

years by better focusing these exams on risk and by spending more time analyzing information before the on-site portion commences. A growing burden is the amount of matters the board of directors is expected to address either directly or through a committee of the board, such as those pertaining to compliance, audit and information technology (IT).

Bankers said that the expanded data fields under HMDA will make an already burdensome process much worse. TRID also has created a huge added burden on the residential lending process. Bankers also said TRID has turned a relatively simple transaction into a complicated and standardized product by which it is very difficult for community banks to distinguish themselves from larger banks. This forced commoditization is not good for the industry and takes away previously offered options from consumers, especially in rural markets.

Bankers described opportunities to better streamline examination processes. The industry has room to improve in the area of imaging complete loan files to allow more off-site loan review. This would allow regulators to make better use of information requested off-site in order to shorten on-site examination.

Bankers said regulatory relief for community banks should include: revision of TRID, insofar as disclosure requirements and time frames are complex, add little value and confuse consumers; a “right-sizing” of HMDA in raising the exemption threshold (as community banks are already under pressure to serve their entire community); revision of appraisal thresholds and appraiser qualification requirements; and exemption of community banks from Basel III.

Small Business Lending

The appraisal process for small business loans was often cited as an issue for community banks. Turnaround time on loans through the Small Business Administration (SBA) also has become an issue. The Community Reinvestment Act (CRA) was said to be outdated; the types of loans that qualify for CRA are seldom aligned with the risk profile of community banks or the credit needs in their communities. Competition is mostly from other banks, but in certain markets credit unions are becoming more aggressive in business lending.

Negative demographic trends were seen as important factors in many rural communities as existing businesses struggle to find enough workers to maintain current activities. Alternative sources of small business loans are starting to appear in rural markets. This trend is likely to continue and grow into a much larger share of the market.

Management Structure and Succession Planning

Succession planning and capital augmentation are challenging in rural markets. Bankers said it is difficult to attract the right kind of people and that agriculture customers have grown in size much faster than banks can grow capital through earnings retention alone. For larger community banks, it is a challenge to grow and at the same time maintain the “feel” and unique qualities of a community bank. Proximity to a larger community can help greatly in efforts to recruit specialty staff such as those in IT, operations and compliance, but these individuals come with a large price tag. Specialty lenders, such as agricultural lenders, are in short supply.

South Dakota *continued*

Banks making a diligent and sustained effort over time to plan for the future have found success. Some are training existing employees for higher-level and specialty positions to fill needs and then hiring new employees for entry-level positions, specifically looking for people that have the desire and ability for promotion.

One bank is working to open more relationships with smaller rural banks to allow them to continue to offer residential mortgage loans. The bank has existing relationships in place that share origination fees and sell loans to the secondary market. This splits the revenue with the local bank and takes the issue of competition off the table.

Technology

Overall, technology presents an opportunity for community banks to offer additional products and services to existing customers and to better compete with larger banks in attracting the next generation of customers. Technology will also allow banks to operate more efficiently internally due to document imaging, core processing enhancements, etc.

These advances come at a steep price, however, as bankers see no indication that IT costs will start to level off anytime soon. Due to a combination of many factors, community banks in South Dakota are spending more on IT-related matters than ever before. A few factors include server upgrades, advanced IT audit schedules, IT security enhancements, and new products and services. One example of a new service is instant-issue debit cards. These allow banks to issue debit cards in their branches in real time in order to overcome the long lag between application and issuance.

The upfront cost of certain IT products may be decreasing but any savings from those limited situations are more than offset by the overall growth in technological costs. Most, if not all, banks are offering more products and services, which drive up their overall IT costs due to the volume of data and the security of that data.

Interpretations of new requirements lead to uncertainty, which leads to additional time and expense. In the absence of clear direction on the Current Expected Credit Loss (CECL) model, some vendors are responding with aggressive sales efforts based on what a particular vendor can offer instead of what a bank really needs. More can be done to clearly communicate expectations and “next steps” to the industry. Community banks know they are going to invest the time, effort and money necessary to make this change but want to know that they are on course to hit the target.



Tennessee

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Community bankers in Tennessee are optimistic about the future of the state's economy. As for the U.S. economy, although it has been growing in recent years, there is still some uncertainty among respondents about the economic stability of the country as a whole. Tennessee bankers are hopeful that the pace of regulatory changes and new rules will slow down under the current administration.

Bankers agree that regulatory burden remains overwhelming and expensive and that it detracts from their ability to serve their local communities. Bankers continue to struggle with complex rules that they say lack clarity. Often, the rules seem redundant, requiring bankers to input the same information on a variety of forms. Complying with mounting regulatory requirements necessitates huge expenditures on human capital, software and third-party relationships.

Bankers noted that, although they are required to spend a significant amount of time complying with the Bank Secrecy Act (BSA), they do not see how that information is used. BSA is an area in which the use of multiple layers of vendor relationships is very costly.

Credit unions and online lenders were named as competitors for the traditional banking services offered by the state's community banks. Credit unions have a competitive advantage by not having to pay federal taxes, enabling them to operate on thinner margins and allowing them to "price out" community banks. Most of the state's bankers cannot come close to matching the rates offered by credit unions and online lenders, specifically in the area of consumer lending.

One issue of growing concern for Tennessee's bankers is elder financial abuse. Bankers feel the issue should be continuously addressed.

Regulation and Supervision

Bankers want examination processes that are tailored to the risk profiles of community banks. The bankers are highly critical of a "one-size-fits-all" approach to regulation. One banker noted that there is too much emphasis placed on the process rather than the results.

However, several bankers agreed that the examination process is improving. Bankers have noticed that examiners are looking to assist them rather than to actively seek out violations. There is a general belief that regulatory relief is underway and that some positive improvements will be made.

Small Business Lending

Community bankers in the state face competition for small business loans from credit unions, nonbank mortgage lenders and larger banks. Generally, all lenders are chasing the same customers, and some of these institutions are willing to take greater risks. With their opportunities for small business lending limited, bankers have focused on commercial real estate (CRE) lending. However, bankers feel limited in this area due to the concentration thresholds in the CRE guidance.

Issues with small business lending are a bit different in rural markets, where the impediments are not regulatory-based but are more related to the risk of putting a small business in a rural market. Capital constraints, business types, the markets themselves and the expertise of

management are a few of the issues faced by bankers when deciding to make these loans in rural markets.

Management Structure and Succession Planning

Bankers agree that attracting skilled talent continues to be a challenge. There is a high demand for skilled compliance professionals, but the supply is limited. One banker noted that the "unknown" about regulation is impacting long-term planning. Until regulatory burden is reduced, confidence regarding the future will be constrained.

Bankers are not optimistic about identifying and recruiting the next generation of staff and management. Some bankers have considered sharing services with other banks, but the competitive nature of the business makes solidifying relationships with nearby banks difficult. Developing the proper roles and responsibilities within the context of the competitive environment presents several challenges.

Technology

Bankers see technology as both a threat and an opportunity. Some community banks embrace technology and the possibilities for reaching new demographics. However, bankers are concerned that millennials have more trust and affinity for nonbank companies, such as Walmart, than they do for their local bank.

Bankers agree that the risk of cyberattacks remains an ever-present threat to their institutions.



Texas

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

In discussing market conditions, many bankers in Texas stated that they are continuing to monitor oil and gas prices closely, given the state's involvement in the oil and gas industry. Other bankers voiced concern about political risk stemming from the inability to reach bipartisan consensus on important policy matters. Some expressed concern regarding the consequences of renegotiating trade agreements and the effect that will have on economic relationships with foreign countries.

The proliferation of third-party payment service providers and coinciding shifts in consumer preferences were noted as concerns, as some bankers felt that the payments systems and bank regulatory structures were not designed to account for such a heavy reliance on third-party providers. Some bankers raised concerns with the growth of the largest banks and concentration in the banking system. These bankers noted a need for greater tailoring in regulation and supervision.

Bankers also articulated that the administration's promise to work on tax amendments, eliminate the Affordable Care Act and address other small business matters were on their minds. Regarding the Dodd-Frank Wall Street Reform and Consumer Protection Act, some bankers hoped that the Consumer Financial Protection Bureau's responsibilities would change. Heightened regulatory transparency and accountability would be helpful to the community banking industry, some noted, as those matters may be the only interim mechanisms that the industry will get now.

Regulation and Supervision

Many bankers expressed concern regarding expanded reporting requirements under the Home Mortgage Disclosure Act (HMDA), noting that their banks have had to create additional processes and expand staff hours to complete the required paperwork and verify and re-verify data. The bankers noted a low tolerance for errors

among examiners and said that examiners are conducting multiple reviews of the same reports.

The bankers noted that the Integrated Disclosure Rule forms under the Truth in Lending and Real Estate Settlement Procedures acts are delaying the closing process. One noted that it has resulted in several customers stranded over a week-end with children, pets and a moving van of furniture. The bankers expressed frustration regarding these delays, because it is difficult to explain to a customer in a "dire" and "displaced situation" the rigid guidelines and required delays. On fair lending supervision, bankers expressed frustration regarding both the burden to prove compliance in this area and the fact that a history of strong compliance with fair lending requirements is not taken into account in current consumer compliance examinations.

The burdensome supervisory processes associated with Bank Secrecy Act examinations were a common concern, especially among bankers along the Texas/Mexico border. The frequency of Consolidated Report of Condition and Income requirements, particularly the daily and weekly reports, was said to be burdensome to produce and monitor. Some bankers expressed that the high reserves required for deposits with the Federal Reserve System seemed excessive.

On supervisory processes in general, bankers noted that consumer compliance examinations are burdensome, not only because they are time-consuming and labor intensive, but also because expectations for them seem to shift from one examiner to another. Some bankers felt that the requirement to develop internal compliance policies is a fruitless exercise that does not result in greater compliance but is simply nitpicking on small issues unrelated to truly substantive matters. Some bankers noted a positive experience with uploading pre-examination request lists but also noted that some examiners may want additional information outside the scope of them.

Small Business Lending

Bankers noted that small business lending in the state has generally been strong. Infrastructure and construction are exploding, as is the population. The market is providing banks with some great commercial real estate (CRE) opportunities; however, banks are still restricted at the 300 percent threshold, which is creating challenges. Some bankers noted that they are avoiding commercial loans because they end up restricting their CRE lending efforts and niches.

Some bankers criticized the general costs associated with originating small-dollar business loans versus larger business credits and noted advantages of larger institutions and credit in this market. Others were concerned that proposed HMDA-like reporting requirements for small business loan data would have an adverse effect on small business lending in general. Competition in business lending is driven mostly by local community banks and, to a lesser degree, credit unions. Large banks were also aggressive competitors.

On the CRE lending front, some bankers continue to face the constant monitoring strain of CRE supervisory guidelines. "Perhaps there should be some thought given to adjusting the ratios," one banker noted. Another said that, "Alternatively, perhaps the supervisory agencies could look at the bank's historical lending patterns, models and experience with CRE and be given some additional room based on past performance and portfolio composition."

Management Structure and Succession Planning

Bankers said that long-term planning is being impacted by a younger generation's (30-year-old age group) avoidance of banking as a profession. Being able to find qualified people to fill roles of retiring senior management is a top-of-mind matter. In addition, some bankers noted that the lack of qualified people in the market is making it more expensive to keep current staff.

Texas *continued*

Long-term concerns mentioned by some bankers revolved principally around staffing and how to attract more millennials. One banker noted, “We have recently done an extensive rewrite of our Human Resources Policy and Employee Handbook. We addressed the historical and existing policies and had focus sessions on whether those policies continued to serve a purpose today.”

Bankers stated that they have entertained various work/life balance approaches. They also are creating more flexible work schedules and locations. Different generational strategies and thought processes surrounding work productivity and culture were said to have been key in accommodating and integrating the valuable insights provided by baby boomers.

Another area of concern in long-term planning is balance-sheet composition. One banker noted that his institution historically has been characterized as having high-demand deposits relative to time deposits. Strong loan demand was also part of the equation. Bankers noted that it is important that the public maintains confidence in deposit insurance coverage, particularly in rural communities. A loss of confidence in deposit insurance coverage could potentially cause a real threat to community bank funding. Texas bankers generally agreed that balance-sheet composition changes should be implemented over time.

In regard to branching decisions, one banker noted that “many of the surveys still show that community bank customers still want to see brick and mortar, regardless of whether they physically visit a branch.” The banker also noted that branch decisions are really decisions to invest in human resources.

Technology

Bankers generally indicated that technology smooths, rather than hinders, business operations. Some bankers consider innovations in banking technology to be both a threat and an opportunity; they say more forward-looking analysis to investing in banking technology is critical.

For community banks, the challenge in deploying the latest technology will depend on the cost of entry. If technology with electronic payments and transfers continues to develop, and consumers embrace using third-party, noninsured depositories or alternative forms of currencies, banks will be impacted. Bankers also noted that enhanced customer-engaging technologies, like more interactive automated teller machines and robust online banking resources, are beneficial on various fronts. Some reliance on third-party vendor relationships was noted. Technology and technological innovation are becoming areas that need attention in order for banks to stay competitive.



Utah

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Utah bankers are reportedly facing more competition from traditional banks than from emerging competitors. While fintech firms have the potential to pose a competitive threat, bankers have not yet seen tremendous inroads. Reporting on the status of third-party relationships, bankers said that finding appraisers for rural properties remains a challenge. Financial literacy also was named as a growing problem. Access to basic resources (e.g., water) has reportedly had a marked effect on local communities and economies.

Regulation and Supervision

Bankers expressed frustration with how long it takes regulators to complete examinations. They said that examinations, particularly those focused on information technology, continue for longer periods, making it difficult to conduct business. They identified a need for greater tailoring in the examination and supervision of community banks, noting that smaller banks do not present a material risk to the Deposit Insurance Fund. They expressed frustration with how often the same information (e.g., an organizational chart) is requested without any consideration as to whether the information has changed since it was last reported.

Bankers noted that the need to be responsive to consumers is increasingly affecting their service and product offerings. The ongoing trend toward electronic delivery of services has continued, making the terms “technology” and “service” interchangeable to some extent.

The complexity of regulations has forced many bankers to receive prior approval for many transactions. Bankers attributed the complexity of regulations largely to their being written by individuals who have never run or worked in a bank. They reported that a lack of understanding among examiners has resulted in strong differences of opinion about products, services, product delivery, structure and strategic vision.

In discussing examination processes, Utah bankers reported that an inordinate amount of time is spent evaluating a bank’s CAMELS components, when many of these ratings have been reviewed for years without any risks identified. Regarding fair lending examinations, bankers said that the only way to accurately conduct an analysis is to do a side-by-side file review; however, examiners often do not engage in such lengthy reviews and rely instead on data shortcuts and assumptions, which can result in tenuous conclusions. Generally, bankers expressed a desire for supervisors to conduct a risk assessment of each bank and to tailor their examinations to the risks posed by that institution.

In terms of regulatory relief, bankers saw the need to revisit the Consumer Financial Protection Bureau’s (CFPB’s) small-dollar loan rule, which in its current form they say would do little to aid borrowers, since consumers are unlikely to understand the new forms and disclosures any better than the previous ones. Overall, bankers felt there should be more exemptions for community banks in CFPB regulations and that the CFPB should focus its resources on targeting subprime and abusive lenders.

Bankers also relayed how time-consuming and cumbersome the Basel III risk-based capital requirements can be, particularly those related to high-volatility commercial real estate. They conveyed that a high capital ratio should allow for a simpler and easier process.

Small Business Lending

Utah bankers are experiencing more competition from credit unions in lending. Also, some banks seem to be lowering underwriting standards, loan-to-value ratios and pricing. Bankers reported no significant competition from virtual or alternative financial services providers.

In discussing factors that challenge their ability to make small business loans, bankers pointed primarily to competition from nonbanks, credit unions and captive finance companies. The latter group reportedly has taken over equipment lending since the financial crisis.

Management Structure and Succession Planning

Bankers cited difficulties in attracting and retaining staff, including a waning interest in banking careers and shrinking pools of specialty staff in areas such as agricultural lending, compliance and information technology. Because of high demand and low supply, bankers said that it makes sense to “home grow” most staff. Overall, they said that attracting and developing sufficient talent is one of the greatest challenges they see going forward.

Bankers also reported difficulty in attracting directors, observing that many qualified people seem hesitant to join a bank due to real or perceived exposure to legal liabilities. There was not much interest reported in adopting a plan for sharing services with other banks.

Technology

Utah bankers expressed concern that larger banks have been aggressively investing in technology, while smaller banks have been lagging behind. They said that technological costs have not declined, adding that while they generally offer what larger regional institutions offer in terms of technology, they often must fight public perception that smaller banks are not equipped with similar offerings. They said that many vendors continue to coax smaller banks into adopting solutions by inculcating fear of the unknown; however, many bankers are better able to filter through vendors to find those that can actually help them.



Vermont

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Vermont bankers are cautiously optimistic about the future. Some said that the trend of partnering with third-party local vendors allows banks to more efficiently serve their markets. Third-party vendors are emerging primarily in the mortgage and commercial lending areas and are usually focused on increasing mortgage origination volume and streamlining application processes. An area of concern is a workforce that is rapidly moving toward retirement, which is resulting in a tightening of the job market.

Regulation and Supervision

Bankers continue to cite regulatory burden related to Qualified Mortgage rules, the Community Reinvestment Act, fair lending regulations and Ability-to-Repay rules. However, bankers are encouraged by reduced burdens associated with financial reporting and the expansion of off-site supervision. They recommended tailoring regulation to bank activities, not asset thresholds.

Small Business Lending

As the Vermont economy improves, bankers are becoming concerned with a failure of future liquidity needs to keep pace with loan demand. Pricing pressures from credit unions, regional banks and out-of-market competitors sometimes impact decision-making and emphasize the need for community banks to rely on local

knowledge and local decision-making. Lenders who compete in the more heavily populated Chittenden County were said to experience heightened pricing pressures.

Appraiser availability—and access to appraisers with knowledge of assessing properties with eco-friendly and green improvements—sometimes impacts the mortgage application process and loan options. Appraiser availability in the rural markets of Vermont is likely to become more of an issue.

Management Structure and Succession Planning

Succession planning is a primary concern. Especially in rural markets, there is a need for qualified candidates to be commercial lenders and senior managers. The option of sharing services among noncompeting institutions has received little attention as a viable alternative to filling positions.

Technology

Innovation in information technology (IT) appears to be both a challenge and an opportunity. Innovation presents a need for increased resources in the IT area, as well as strategies to address evolving competition from nonbanks. All banks said they have made or are considering significant investments in technological upgrades and/or new applications. One banker mentioned that core provider products are expensive and difficult to implement.

Financial technology also includes technological service providers and third-party vendors, which often streamline bank operations. These improve loan and deposit account application processes; expand the use of product offerings, such as foreign currency debit cards; and improve online account opening applications. Once paid for and implemented, technology advancements appear to improve the customer delivery experience while simplifying bank processing.

Regulatory uncertainty is a consideration when evaluating new products and services, but, as one banker expressed, “We all want to be a high-touch, relationship-centered community bank, but we also have to adapt and offer innovative products and services that consumers demand to stay relevant.”



Virginia

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Virginia bankers are concerned with competition as credit unions move into commercial lending and aggressively compete with community banks. The increased competition overshadows the benefits of growth and improvements to their local economies, bankers said. One banker noted, “Two major credit unions in our market have become increasingly competitive in the deposit and commercial banking arenas.”

Bankers cited regulatory burden either as a cost issue or as a factor in products they could or should offer. The bankers also cited problems in keeping up with technology. They described efforts to support financial education and to help meet the needs of minority communities and younger consumers.

Regulation and Supervision

Bankers said they prefer knowledgeable, experienced examiners who have a full understanding of the laws and regulations they are administering, as well as an ability to make accurate, practical applications of them. One banker said, “As regulatory concerns increase, lenders must choose between market and regulatory risks, placing a potential damper on regional economic growth.” Another said that the “complexity of the regulations has a significant influence on how products are built and delivered.”

Bankers are troubled by mortgage regulations that create risk and expense. One said, “We do not currently offer a portfolio of residential mortgage purchase money loans because of the compliance and qualified mortgage regulations.” Requirements under the Bank Secrecy Act (BSA) and the

Home Mortgage Disclosure Act (HMDA) also were blamed for creating compliance expenses that exceed practical value. One banker said, “HMDA rule changes double the bank’s loan monitoring and reporting requirements, reducing the client experience and increasing overhead.”

Bankers recommended that examinations include more user-friendly email and file transfer systems. They also support a shorter on-site presence. One banker said, “In many cases, the regulations are so new and/or complicated that the examination staff doesn’t understand how they should be implemented.”

Small Business Lending

Bankers are concerned about competition with other community banks and/or credit unions. The bankers said costly complexities for small business loans include requirements of the Small Business Administration and a lack of uniformity between loans. Pricing was said to be a major factor driving decisions.

Bankers indicated they are not compromising underwriting standards. One said that banks “would benefit from a specific definition of small business loans to encourage consistency and the ability to properly frame an automated process.” Another noted that the “biggest issue with small business loans is determining how to underwrite small loans in a cost-effective way.”

Management Structure and Succession Planning

While the markets and quality of life in several Virginia markets are cited as helpful in staffing for community banks, bankers indicated at least some level of concern in

this area. Several said they would have to go to the market to replace key employees and/or specialists in information technology, BSA or commercial lending. One banker said, “Being a small bank in a small town creates problems to obtain proper talented staff from time to time.” Another noted, “Good commercial loan officers are in high demand.”

Sharing or third-party providers have added some benefits, as have loan participations, but they are limited by issues with privacy, culture, quality and independence. One banker noted the “ever-dwindling number of community banks with which to partner” and “increased staff/expense dedicated to compliance and internal audit.”

Technology

Virginia bankers said that overall costs for technology are rising, as any efficiencies in core services are being offset by expenses for new services, cybersecurity, network updates and personnel. The main impact of regulatory uncertainty is for services tied to compliance with requirements under the Current Expected Credit Loss (CECL) model and HMDA. Bankers were concerned about a lack of competition in core service providers, which puts community banks at a disadvantage regarding pricing and contract terms.



Washington

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Community bankers in the state of Washington reported that local economic conditions are generally strong, particularly in the more densely populated western side of the state. Real estate prices are increasing in the Puget Sound area, and competition for loans is intense; there is a sense that this market may be overheating. Some other markets are very dependent on a small group of large employers.

Small retail businesses in the state are struggling due to competition primarily from one large company. Banks are now seeing increased competition from credit unions in areas where they have not historically been active. In some cases, the terms and conditions offered by credit unions are impossible for community banks to match. Credit union competition continues to pressure margins due to what bankers called their unfair tax structure and lax regulatory oversight.

Washington bankers said that a narrow labor market is limiting their ability to find quality employees. Increased housing costs are making this problem worse, as potential employees are forced to relocate elsewhere. High housing prices have led one bank to seek loans outside of the Seattle area because prices in this urban market are not reasonable relative to wages. This bank is choosing to lend in outlying areas where housing affordability indices are at more acceptable levels.

A recent decision by the Washington State Supreme Court on water rights was said to have limited the chances for development by customers and for properties in rural areas that need private wells. Bankers are concerned about the impact on collateral values and the ability to lend. In addition, the state is contemplating increasing

taxes to fully fund education. Bankers are concerned that this may have an impact on businesses and the local economy.

Regulation and Supervision

Washington's community bankers would like clarity with respect to the Trump administration's plans for tax reform and regulatory relief. The uncertainty inhibits businesses' plans to expand or change their business plans and investments. Uncertainty about how much capital will be required in the future is impacting banks' strategic planning. Bankers also are seeking more clarity from the federal government on providing banking services to cannabis-related businesses.

Bankers are concerned about the stickiness of bank deposits, given the uncertainty over what the Federal Reserve will do with market liquidity. They are also concerned about economic forecasts, rising interest rates and a flattening yield curve. They are not seeing as much improvement in margins as was expected with the rate increases. Economic data suggest a downturn may be near, they said.

The most time-consuming and burdensome supervisory processes center on consumer compliance examinations and regulations. In one case, an examination issue regarding reverse mortgages was sent to Washington, D.C., for review. This caused a delay of results under the Community Reinvestment Act for more than seven months, during which the bank was never informed of the regulator's concerns. Despite what they called onerous examinations, bankers do not feel like they come away with the information needed to understand how to fix errors and comply with the rules going forward.

Bankers in the state hope that the process can become more constructive and that findings can be communicated on a timely basis.

Bankers are very concerned about the pending implementation of expanded reporting requirements under the Home Mortgage Disclosure Act (HMDA), as well as compliance with the Integrated Disclosure Rule under the Truth in Lending and Real Estate Settlement Procedures acts. These concerns have caused some banks to significantly scale back mortgage and consumer lending. Unfortunately, these rules are having an impact on the entire market, as customers report a difficult time finding loans.

Bankers are also concerned that the efforts of the Consumer Financial Protection Bureau to collect data on small business loans will provide no benefit to consumers or banks. Implementation of the Current Expected Credit Loss (CECL) accounting standards also is viewed as very onerous for smaller banks. Regulatory relief priorities include the repeal of the Durbin amendment, relaxation of HMDA requirements and changes to the Herfindahl-Hirschman Index used to measure market concentration in the context of community bank mergers and acquisitions.

Small Business Lending

Washington's community bankers say it is impossible to separate consumer lending from small business lending. New consumer regulations are stacking up, and they are often preventing consumers from accessing responsible sources of credit. One bank is exploring fintech options for small business lending as a way of streamlining processes. Another noted the high

Washington *continued*

cost of setting up a small business lending platform, due at least in part to the lack of a uniform way to classify small business loans (similar to Uniform Retail Credit Classification guidance).

Management Structure and Succession Planning

Succession planning has been a challenge for the state's community banks. Bankers indicated a need to do more planning for retirements that are expected in the next three to five years and to think strategically about areas of the bank that will need more resources and talent. It is becoming increasingly difficult to find specialists in areas such as those related to the Bank Secrecy Act (BSA), especially in rural areas. Retaining and attracting qualified individuals who have the skills for a growing bank are concerns.

Technology

Community bankers in the state view innovations in banking technology as opportunities that also pose challenges. New technologies allow smaller banks to compete with larger organizations, but the technologies are expensive and time-consuming to implement. Larger institutions are viewed as having an advantage in their ability to adopt new technologies and meet customers' needs for faster, more convenient service. This has led to a belief, by some, that finding a more specialized niche is the future of community banking. Technology can

allow community banks to narrow their focus and better define whom they want to reach.

The activities of nonbank competitors also provide opportunities and challenges to community banks. Nonbank financial service providers have the technology to serve customers but not the relationships with them, bankers said. Therefore, there is a need to form partnerships with these firms to enhance both business models.

One banker noted the need to fully utilize the technology and products that banks already have. For example, one bank that could not find a particular piece of information from its core service provider realized that its BSA software contained the data it needed. Overall, community bankers in the state are increasing their focus on technology and investing in many areas, including e-signatures, expanded account analysis, information security and online loan applications.



Wisconsin

FIVE QUESTIONS FOR FIVE BANKERS | 2017 NATIONAL SURVEY

Local Market Conditions

Workforce issues are a primary concern for Wisconsin's bankers, both for the financial institutions they operate and for the communities they serve. Banks, especially those in smaller markets, are finding it difficult to attract and retain employees with the necessary skill sets. Even for banks that are located near larger cities, there can be a perception that an institution is "in the middle of nowhere," making recruitment more difficult. Some bankers said they are forced to overpay for the employees they hire in order to fill vacancies.

Compounding this problem is a lack of adequate training programs, especially those that used to be prevalent at larger regional banks, which provided a pool of employees from which smaller banks could recruit. Similarly, workforce issues are impacting many communities across the state. Historically low unemployment rates and a skills gap among potential employees have combined to have a chilling effect on economic growth in many markets.

Continued competition from credit unions—especially larger ones—was cited as a concern by some bankers. Credit unions, in some cases, are offering loans with lower interest rates and longer terms than banks can offer. Some credit unions are buying community banks. Some bankers believe this competitive threat will only increase with the continued trend of smaller credit unions being acquired by larger institutions.

Some bankers also questioned whether the federal regulatory burden is forcing some institutions to stop offering traditional products, such as mortgages. As one banker explained, "If it takes equal effort to make a \$200,000 home loan vs. a \$750,000 business loan, but the bank makes more money on the business loan, why would a bank waste time on the less profitable mortgage?"

Overall, the Wisconsin economy is viewed as being very strong and a positive for the banking industry, although there are pockets of weakness, such as some rural areas.

Regulation and Supervision

The examination process for both state and federal examiners was cited as being time-consuming and, at times, burdensome. Overall, bank executives gave the Wisconsin Department of Financial Institutions high marks for keeping the examination process as reasonable as possible, but the bankers gave lower marks for examinations conducted by federal regulators. Among the bankers' comments about the examination process:

- The practice of conducting some portions of the examination online or over the phone is good, but don't let the pendulum swing too far. There is an advantage to having examiners and bank staff interact face to face. It is important to have the examiner-in-charge on-site.

- State and federal regulators should coordinate their examination schedules so that both are not in the same bank at the same time.
- The sheer totality of regulations (mainly federal) is a burden on banks and their staff. It's not one single regulation; it's the growing volume of them. The whole is greater than the sum of the parts. It's death by a thousand cuts.

Small Business Lending

Some banks have seen a significant growth in commercial real estate (CRE) loans in recent years, leading to some concerns over concentration, but most bankers believe their portfolios are strong. Some of the impediments facing banks are:

- Market consolidations are putting pressure on smaller community banks' ability to do CRE lending. When a midsize firm buys a smaller business, community banks are finding it more difficult to compete with larger banks for the loan.
- "Guidance" that CRE concentration not be more than 300 percent of the institution's total capital seems more of a hard requirement than guidance.
- Significant shifts in retail from bricks-and-mortar locations to online portals have dampened demand for lending.
- One executive said his institution will no longer make CRE loans on strip malls.

Wisconsin *continued*

- As the agricultural sector has come under some stress in recent months, such lending has been curtailed.
- Small multifamily housing units shouldn't count toward CRE. One banker said he could have made more multifamily loans if not for multifamily counting as CRE.

Management Structure and Succession Planning

Finding good employees is a challenge for many community banks, negatively impacting succession planning at multiple levels. It is especially difficult to attract employees to work in information technology (IT), compliance and mortgage lending. It has become increasingly difficult to find mortgage lenders who possess the unique skill set of a “good salesperson” and a “good compliance person,” while at the same time limiting them to a 40-hour workweek. This challenge has been made more difficult by merger trends within the industry, as fewer banks have resulted in a smaller pool of knowledgeable and available potential employees.

Regarding succession planning, the consensus opinion of bankers was that smaller banks are at a disadvantage because it is more difficult to have redundancies and backups in place for all critical duties when staff size is small. Also, as federal regulation has increased, more employees have been forced to specialize in certain areas, which has diminished staff flexibility.

Technology

All bankers who were interviewed said they view technology as both a threat and an opportunity. Customer expectations are driving banks to offer more and more technology products and services, but with that demand come increased cybersecurity risks and expense. Several bankers remarked that their employees have, in certain respects, become “IT support” for their customers, which has added a new demand on bank employees' time. Younger customers, especially, expect a host of digital products at no cost to them, which means that the bank must offset the expense in some other way.

The risk associated with technology was highlighted by one banker, who said he doesn't spend a lot of time worrying about the performance of his loan portfolio of several hundred million dollars. What keeps him up at night is the possibility of a customer's computer getting breached by a hacker who then hoodwinks the bank into issuing a bogus \$900,000 wire transfer.

Wyoming

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Local Market Conditions

Community bankers in Wyoming said their greatest concerns on a national level are the current state of the federal government and its elected officials, the economy and the flattening yield curve. Bankers also expressed concern about the state's reliance on the energy industry. As a mineral-based economy, in a period of decreasing energy prices and increasing carbon output concerns, Wyoming will likely face a period of economic hardship, which is a 180-degree turn from the past 10 years of robust mineral-based income and jobs. Bankers also noted that cybercrime is becoming more complex, more sophisticated and intrusive with ever-evolving technology and enhanced reliance on cyber-based programs and systems. Smaller banks have limited resources with which to protect themselves and their customers.

Legislatively, Wyoming's bankers seek reform on a number of issues. They would like to see: passage of legislation to ease regulatory burdens on small community banks that they said were brought on by Dodd-Frank; passage of tax reform to lower tax burdens on individuals and small businesses; passage of legislation to commence national infrastructure work; improvements to the Affordable Care Act to lower health care costs and halt escalating health insurance premiums; and the removal of what they see as the artificially low interest rate policies of the Federal Open Market Committee.

Some bankers stated that the Consumer Financial Protection Bureau needs to answer to more stakeholders; others suggested that community banks need a different regulatory regime relative to larger banks. With regard to the Home Mortgage Disclosure Act (HMDA) and new data collection requirements under the act, some bankers noted that increasing the number of required data points that must be collected from 25 to more than 40 will require hiring more employees, who are both expensive to employ and hard to find.

Data collection requirements on Small Business Administration loans were said to be "just as bad."

Regulation and Supervision

Bankers said that the Current Expected Credit Loss (CECL) model is a concern, particularly its "blanket approach." They mentioned that CECL may be good for big banks but it creates a lot of unnecessary work for community banks. Bankers noted that some regulators don't fully understand CECL themselves.

Some bankers would like to see a reduction in Call Report requirements. One banker noted that the No. 1 concern for a community bank used to be the customer, but now community banks are more concerned about their regulator. The dollar cost of compliance and doing the regulatory work is growing and becoming a major budget issue because compliance costs directly reduce profitability and, therefore, impact the long-term survivability of the institution.

Some bankers noted that the exam process has become more burdensome. For example, the requirement to produce and share documents prior to and during the exam is seen as particularly onerous. One banker suggested that exams be more specifically tailored to areas that may have more apparent risk. Often, questions are asked by examiners during the exam that suggest that the information shared prior to the exam was not reviewed and/or not reviewed correctly. In addition, bankers reported that regulators are requiring more bank actions be "proved" in the bank's board minutes and detailed in writing. Bankers mentioned receiving significant criticism when documentation doesn't exist on a certain action, regardless of whether the practices the bank is engaging in are adequately managed and no safety and soundness weaknesses are exhibited.

Bankers also noted that many of the individual components of their confidential CAMELS ratings appear to be analyzed

and rated based on historical information and analytical hindsight, with little to no consideration made for current or future actions and trends. One banker indicated that he felt that his bank had a good working relationship with state and federal examiners. The banker mentioned that earlier in his career, he worked at a "troubled" institution, and even then, the examiners functioned more as "team players" instead of as "sheriffs." He did mention, however, that the time between exams seems to be decreasing. In contrast, another banker noted that the supervisory process has actually become more efficient over the past few years, especially with off-site work being conducted prior to and after the exam. The banker specifically mentioned that his exams had become more efficient since converting to a state charter.

Small Business Lending

Wyoming bankers feel that many business borrowers aren't familiar with the small business loan process and, therefore, many of the current challenges in small business lending are self-imposed by the borrower. For example, many borrowers don't understand capital, retained earnings or cash flow. Some bankers noted that their "bread and butter" is still commercial real estate (CRE) lending, an area where business is "good" and is represented by fewer speculative loans.

One banker noted that small businesses remain unsure about the U.S. economy and are concerned about the rising interest rate environment. The bankers also noted a general lack of "entrepreneurial spirit" in their communities, as fewer individuals are actually starting businesses.

Wyoming bankers are concerned that banking regulations are making it more difficult to lend to small business or extend CRE credits. For example, the costs to comply with current CRE regulations, including appraisal requirements, are seen as exorbitant, extremely technical

Wyoming *continued*

and time-consuming, and often provide minimal safety and soundness benefit. For smaller community banks, lenders are very good at understanding the creditworthiness of their loan applicants, but often lack the complex technical skills to ensure that the loan is compliant with current consumer compliance regulations.

One Wyoming banker noted that the current regulatory environment has created a situation where it is “easier to say ‘no’ than ‘yes’” when making a lending decision. Banking regulations are also incentivizing lenders to seek other methods for collateralizing a loan instead of using real estate, even when a mortgage would be the best collateral for risk mitigation purposes. On the other hand, another banker mentioned that the only challenge he was facing in regard to making small business or commercial real estate loans was increased competition. In fact, some bankers indicated that loan demand for small business and CRE loans is actually quite strong, but that the interest rate environment is competitive and cutthroat. One banker noted that the 300 percent concentration limit for CRE loans is a problem given the high demand for these types of loans.

Management Structure and Succession Planning

Wyoming bankers are seeing “a lack of younger individuals willing to work up through the ranks” at banks. They also noted challenges in finding the right talent in their communities that could be trained to be future business leaders. Some bankers also cited a lack of loyalty among existing employees. Some bankers are trying to work with local universities to get more young people to enter the field.

Bankers noted a growing concern among shareholders that today’s bank returns might be “as good as it will get.” Shareholders are asking questions about whether now is the right time to sell the bank rather than face another recession, potential market bubbles, increased

regulatory complexity, and/or cybercrime issues. Also, there is a growing concern that smaller banks will not be able to keep up with the growing complexity of the banking industry.

Regulatory and supervisory issues are other main factors impacting a bank’s long-term planning strategy. Lesser factors are more territory-specific, such as changes in the federal energy policy, changes to federal tax law and the easing of Dodd-Frank rules on small community banks.

Technology

Bankers believe technology will have very significant impacts over the next 10 years as artificial intelligence comes online and begins replacing and/or augmenting human activity. Some bankers consider changes or innovations in banking technology to be both a threat and an opportunity. Bankers said that due to regulation, it takes a smaller bank much longer to implement new technology.

Bankers noted that a community bank cannot compete with the unregulated fintech industry but will eventually be required to offer newer, more aligned services/products—not as a differentiator but as a means of keeping pace. Some bankers said that the “so-called innovations are a threat” and that fintech and large regional banks don’t provide the same investment in communities as community banks do.

One banker stated that technological advancements are driving the banking industry forward and, for that reason, his bank works hard to stay up to speed on new technologies. The banker stated that it’s important to provide the same “big bank technology” to his customers without losing the personal touches (i.e., relationship approach) provided by a small-town community bank.

