2023 CSBS Annual Survey of Community Banks

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Findings from the 2023 CSBS Annual Survey of Community Banks Presented at the 11th Annual Community Banking Research Conference

Oct. 4-5, 2023

To view online, please visit: csbs.org/survey2023

Letter from I. Lise Kruse

The impact of continued high interest rates has hit Main Street.

The 2023 Annual Community Bank Survey shows that while net interest margins continue to be the top external challenge for community bankers for the second year in a row, their concerns in three related areas have risen dramatically.

More than 86% of respondents named cost of funds as either extremely or very important, a significant increase from the 48% who said so last year. Likewise, 83% of respondents called core deposit growth extremely or very important, up from only 38% a year ago. And liquidity concerns were cited by 83% of respondents as extremely or very important compared to 35% a year ago.

Meanwhile, community bankers ranked cybersecurity threats as their top internal concern once again.

This is the 10th year of our annual survey and looking through the years gives a great view of the top concerns and challenges of community banks. We are also fortunate to have insight from five community bankers who have provided a close-up look at their operations.

I'd like to thank everyone who participated. Your input is invaluable. The information is important to understand more about community banking and helps inform both regulators and policymakers.

To learn more about what's on the minds of community bankers this year, I invite you to read the full report.

I. Lise Kruse

Board Chair, Conference of State Bank Supervisors
Commissioner, North Dakota Department of Financial Institutions

2023 CSBS Annual Survey

Introduction

The 2023 Annual Survey of Community Banks, conducted by the Conference of State Bank Supervisors (CSBS) and state banking supervisors, was issued in the wake of several macroeconomic headwinds, intensified by heightened deposit competition and uncertainty in the banking system, stemming from the failures of three large regional banks earlier in the year. Additionally, a large bank with significant exposure to the crypto industry began the process of self-liquidation in early March 2023. Notably, the federal funds rate continued to increase, putting pressure on long-dated securities in bank portfolios, leading to significant unrealized losses for some banks.[1]

In the face of these stresses, the U.S. Treasury Department secretary authorized the creation of the Bank Term Funding Program (BTFP) to provide liquidity to banks that were experiencing balance sheet stress and to stem the outflow of deposits from banking organizations seen as vulnerable in this environment. Launched on March 12, 2023, the BTFP offers loans of up to one year to eligible depository institutions that pledge U.S. Treasury securities, agency debt and mortgage-backed securities, and other qualifying collateral. The assets pledged are valued at par instead of at market value. The program closes March 11, 2024. As of Aug. 3, 2023, more than $105 billion had been distributed.[2] The overall impact of the program will not be known until next year and will likely be an area of focus in the 2024 annual survey.

The stresses that surfaced in early 2023, however, did not trigger a wider banking crisis because of several factors, including higher net interest incomes, strong capital ratios and solid loan growth at community banks.

But as 2023 progressed, there were signs of headwinds: Loan growth was beginning to slow on fears that the broader U.S. economy may be contracting. Deposit competition was placing pressure on margins. In addition, increasing overhead costs, primarily in the form of personnel and data processing expenses, continued to negatively influence efficiency measures. The CSBS Community Bank Sentiment Index—which in July 2023 showed the lowest reading since the quarterly index was first published in the second quarter of 2019—highlighted many persistent concerns of community bankers: government regulation, cyberattacks, inflation, the federal debt and deficit, and the cost and availability of labor.[3]

The CSBS Annual Survey of Community Banks was launched in 2014, the second year of the Community Banking Research Conference. Each year, some questions are added to the survey; some reflect emerging issues, while others address issues that are more temporary in nature. Most questions, however, are asked every year and have shown how the opportunities and challenges facing community banks have evolved over a decade. The survey report also incorporates comments from interviews that were conducted with five community bankers from across the United States. The interviews, commonly referred to as "Five Questions for Five Bankers," provide important context around the survey findings, while offering a unique window into the thinking of five active industry practitioners. Transcripts of the complete interviews can be found in the last section of this survey report. CSBS is grateful to these bankers for sharing their candid perspectives in support of the 2023 Annual Survey of Community Banks.

Key Findings

- Net interest margins were generally seen as the top external risk by community banks. More than 88% of respondents listed them as either "extremely important" or "very important." Cost of funds was identified as the second most important external risk.
- A majority of respondents reported higher costs of deposits as the most impactful effect of inflation. Higher personnel expenses were ranked second.
- While the majority of respondents viewed the challenges created by inflation as likely to persist, three-quarters viewed these challenges as manageable.
- Regarding internal risks, cybersecurity continued to receive the largest share of bankers identifying it as "extremely important" or "very important." Liquidity ranked second overall. While staff retention also remained an important internal risk, the number of bankers considering it either "extremely important" or "very important" was down from close to 85% last year, perhaps consistent with some cooling in labor turnover relative to last year.
- New and emerging technologies are important tools for banks to meet customer demand. Nearly all banks surveyed identified the adoption of new or emerging technologies as important.
- Costs and implementation remain the largest impediments to adoption of new and emerging technologies, followed by limitations of core service providers.
- Despite any limitations, close to two-thirds of respondents reported relying on core service providers for digital banking products and services and were not seeking any partnerships with other digital providers, such as fintech firms.

Key Findings, cont.

- More than 70% of bankers reported that addressing the cryptocurrency needs of bank customers was not an important part of their business, up from 51% in 2022. Indeed, nearly all respondents reported they are not currently offering crypto services and do not plan to offer them in at least the next 12 months.
- As banks compete for deposits and rely more on wholesale funding sources to meet their liquidity needs, banks' funding costs are up.
- Community banks appear to have regained more of their competitive edge for agricultural loans against nonbanks, such as the Farm Credit System; more community banks named other community banks as their primary competitors. This was also the case regarding competition for commercial real estate loans.
- Survey participants indicated that compliance costs, as a percentage of various overhead costs, generally continued to fall.

Background

To develop the 2023 annual survey, CSBS staff met with key industry stakeholders to identify current issues of relevance to community banks. The survey was distributed by the state bank regulators from April to July 2023. The number of respondents was 462.

All responses captured in this report are from institutions with less than $10 billion in total assets—a benchmark for community banks established under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The majority of responses were from state-chartered banks.

The survey does have several limitations, however, as outlined below:

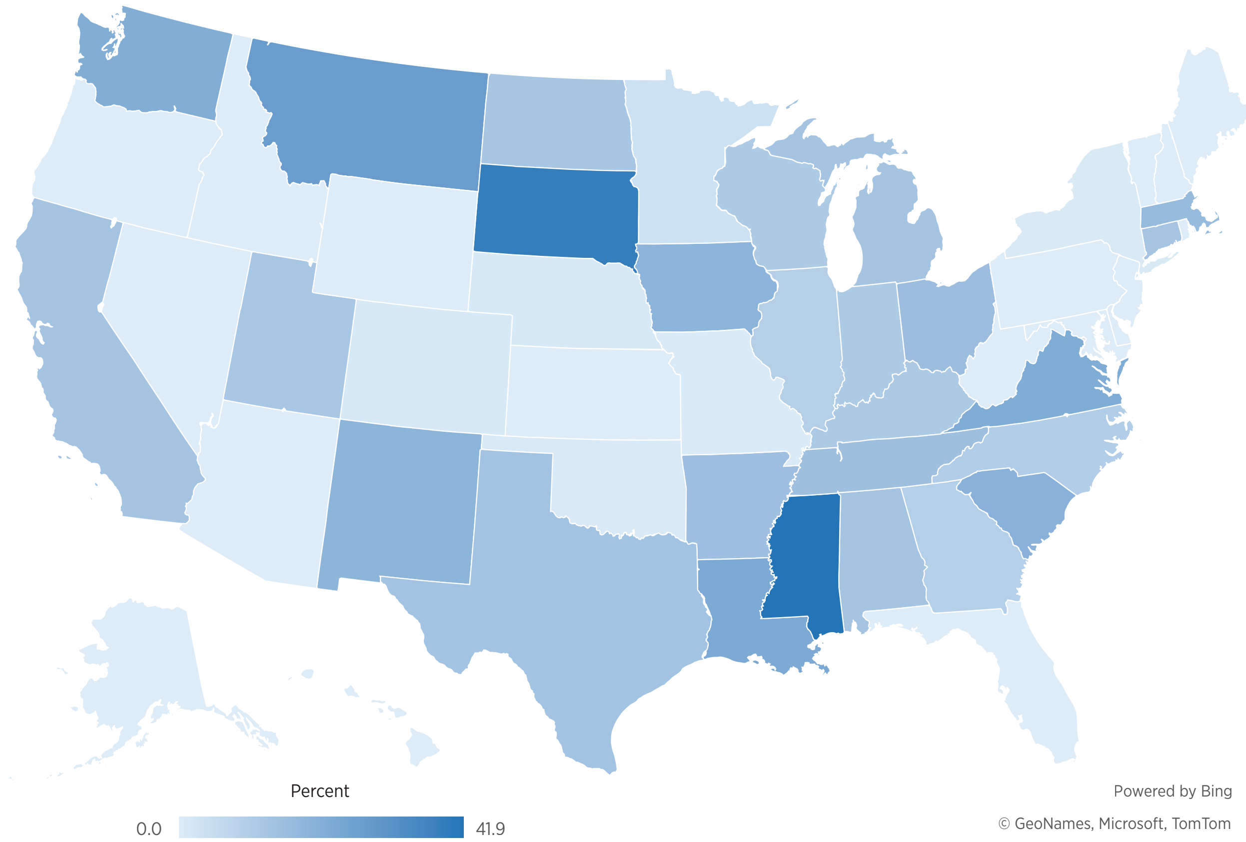
- It was not completed by community banks in every U.S. state and territory. (See map in Figure 1.)
- Respondents participated on a self-selected basis (a "convenience sample").
- Respondents did not necessarily respond to every question in the survey.
- Detailed statistical testing, which would be required to definitively quantify the extent to which the surveyed banks were representative of the overall industry, was not conducted.

Given these limitations, the conclusions in this year's survey report should be quantified accordingly. Because each respondent did not answer every question, responses are expressed as percentages of respondents to specific questions. Because of rounding, not all percentages will sum to exactly 100.

Nevertheless, the responses from the 2023 annual survey provide valuable insights into how the nation's community banks experience key internal and external risks, the marketplace for banking products and services, technology, competition, liquidity and funding, loan participations, compliance costs, and merger and acquisition activity. The findings have implications for researchers, regulators, bankers and policymakers.

FIGURE 1

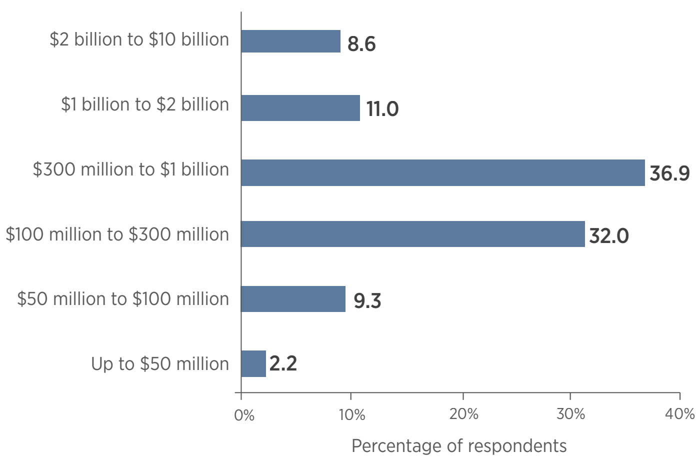
Survey participation rate by state



Participants came from 32 states. The participation rate was the highest in Mississippi and South Dakota. Texas had the largest number of respondents, with 53 banks responding.

FIGURE 2

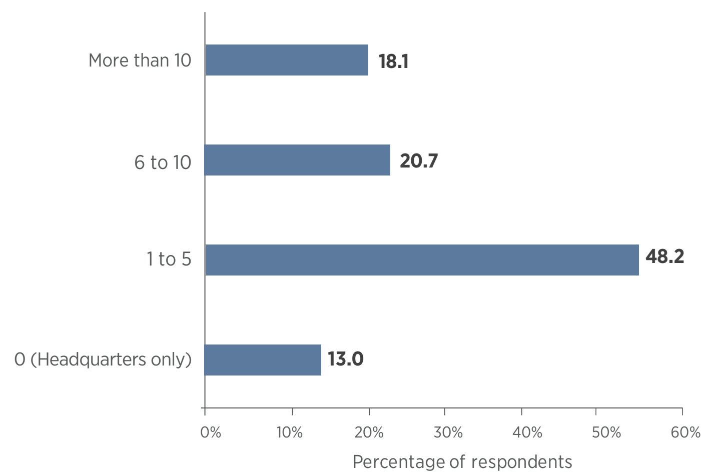
Asset size of surveyed banks



Of the banks surveyed, close to 12% had assets of less than $100 million. Most banks fell within the category of $300 million to $1 billion.

FIGURE 3

Number of branches of surveyed banks



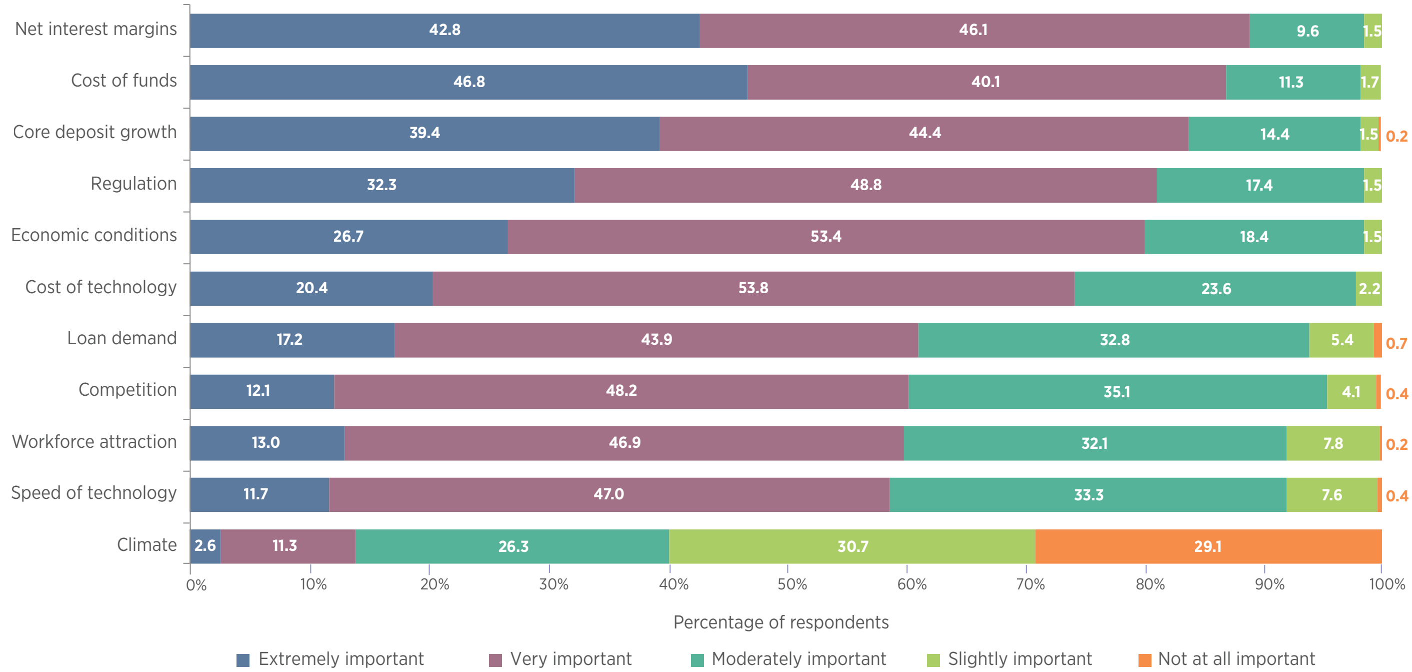
Although close to half of all banks had between one and five branches, significant dispersion is evident by the 13% of banks with no branches and the 18% with more than 10 branches.

EXTERNAL RISKS

When evaluating external risks, bankers placed the most importance on net interest margins, cost of funds, core deposit growth and regulation, with less importance on economic conditions and loan demand relative to 2022 survey findings. The shift in sentiment is consistent with today's higher-interest-rate environment, as well as a stronger emphasis on liquidity.

FIGURE 4

How important are the following external risks to your bank today?



Net interest margins were generally seen as the top external risk by respondents. Nearly 89% of respondents listed them as either "extremely important" or "very important." The overall percentage of respondents classifying net interest margins as either "extremely important" or "very important" was little changed from last year's survey.

Cost of funds was identified as the second most important external risk. Nearly 87% of respondents named it as either "extremely important" or "very important." This percentage is up sharply from the 2022 survey, when approximately 48% of community bankers listed cost of funds as an either "extremely important" or "very important" external risk.

Core deposit growth was viewed as the third most important external risk, with nearly 84% of respondents naming it as an either "extremely important" or "very important" risk. These percentages were also materially higher than in last year's survey, when approximately 38% identified core deposit growth as an either "extremely important" or "very important" external risk.

Regulation continues to factor heavily in the views of community bankers, with more than 81% of respondents indicating that it was an "extremely important" or "very important" external risk. This percentage is slightly higher than what was reported in the 2022 survey.

Additional External Risks

- Bankers expressed less concern around loan demand relative to 2022, with 17% reporting this external risk as "extremely important" and 44% as "very important." These shares were down from 30% and 48% from last year, respectively.
- While falling out of the top-three ranking, economic conditions remained an important external risk among bankers, with roughly 80% of respondents listing them as either "extremely important" or "very important."
- For a second consecutive year, competition ranked near the bottom of external risks, with just 12% of bankers identifying this risk as "extremely important," down from 14% in the 2022 survey and 38% in 2021.
- Respondents cited several other external risks in some of their narrative responses to the survey. These included competition from tax-privileged institutions, fraud, education and training, and government spending.

RISK OF INFLATION

With inflation continuing to run above the Fed's 2% target in the first half of 2023, bankers were asked to rank the most impactful effects of inflation on their banks. A majority (64%) reported higher costs of deposits as the most impactful effect of inflation. Higher personnel expenses were ranked as the second most impactful effect of inflation. Roughly 73% of respondents viewed the challenges created by inflation as likely to persist, and 58% viewed these challenges as likely to persist but still manageable. The majority of bankers expect core inflation to return to the Federal Reserve's 2% target by either 2024 or 2025.

FIGURE 5

How would you rank the following effects of inflation on your bank in terms of level of impact?

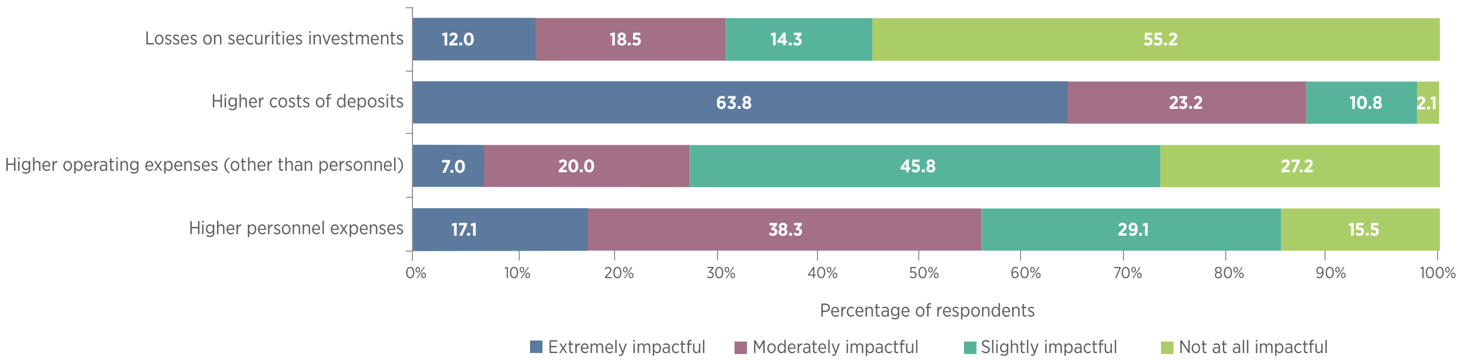


FIGURE 6

How does your bank view inflation challenges?

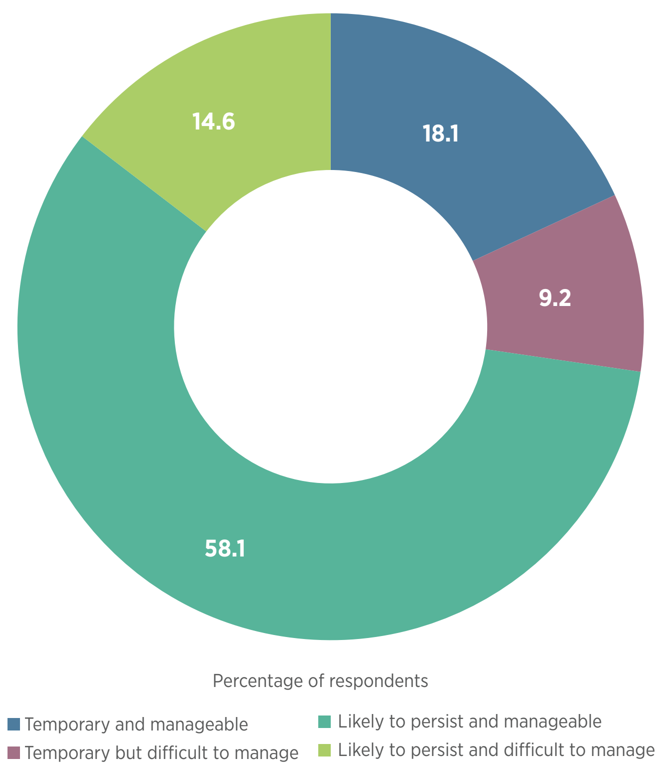
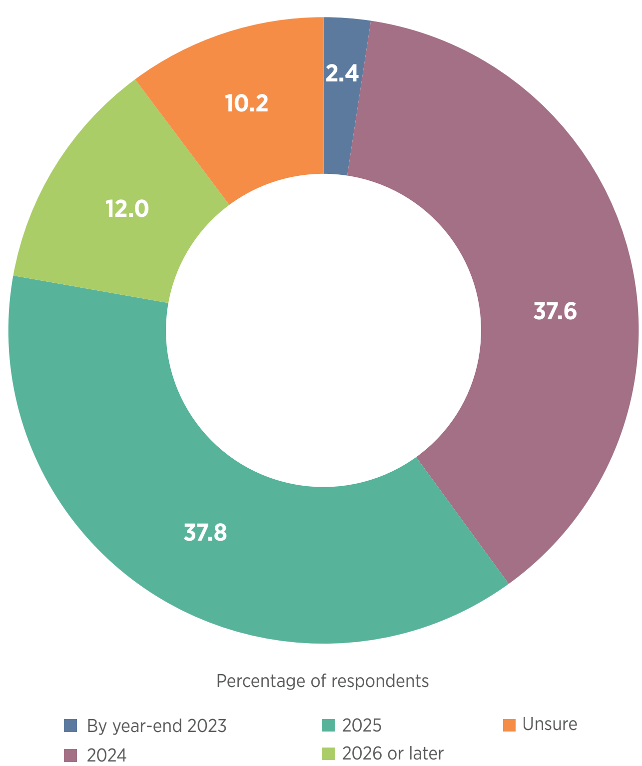


FIGURE 7

When do you expect the year-over-year rate of core inflation to decline to the Fed's 2% target?

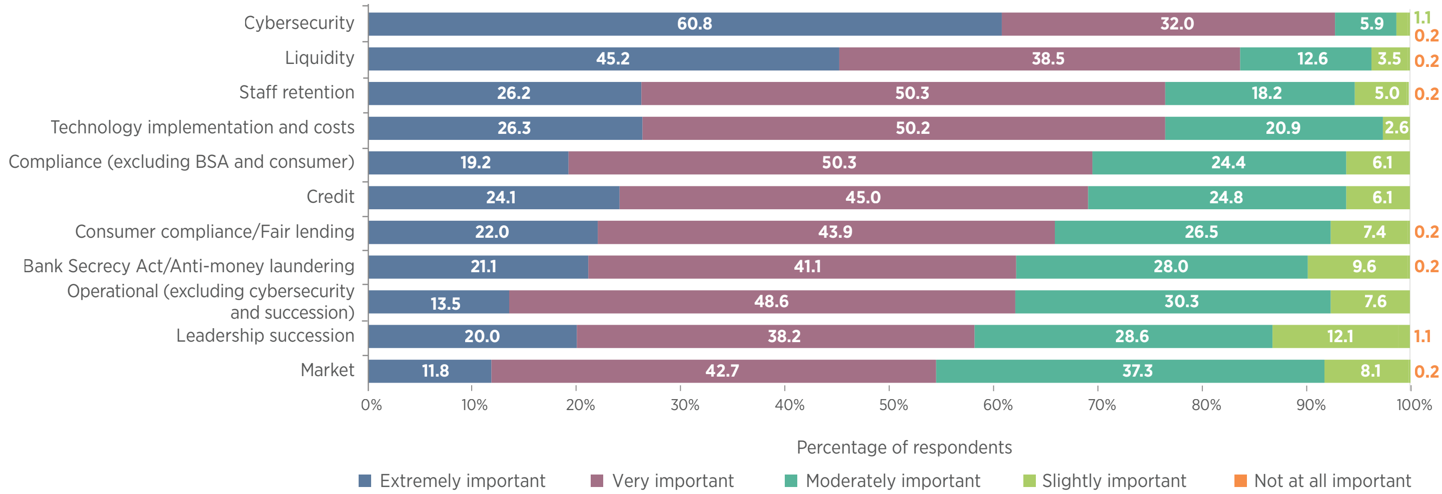


INTERNAL RISKS

Every bank faces risks that are unique to its operations, but some themes carry across all banks. Figure 8 represents the views of survey respondents who were asked to indicate the internal risks they view as important. Cybersecurity continued to receive the largest share of bankers identifying this risk as "extremely important." Liquidity ranked second among internal risks; more than 83% of respondents viewed it as a top risk, indicating that it was either an "extremely important" or "very important" risk. Staff retention, as well as technology implementation and costs, were a close tie for third in the bankers' ratings of internal risk categories.

FIGURE 8

How important are the following internal risks facing your bank today?



Cybersecurity risk was identified as the top internal risk by this year's survey respondents. Nearly 93% of community bankers cited it as an either "extremely important" or "very important" internal risk. While significant, this is down from 2022, when approximately 96% of respondents indicated it was an "extremely important" or "very important" risk.

Liquidity ranked second among internal risks; respondents indicated that it was either an "extremely important" or "very important" risk. More than 83% of respondents viewed it as a top risk. This percentage is up sharply from the 2022 survey, when approximately 35% viewed liquidity as an either "extremely important" or "very important" internal risk. Liquidity was last seen as a top risk in the 2019 annual survey.

Staff retention, as well as technology implementation and costs, were essentially tied for third in terms of the top bankers' ratings of internal risk categories, with slightly more than 76% of bankers considering them either "extremely important" or "very important" internal risks.

Bankers' Perspectives:

Liquidity is, of course, a concern for all of us. As best we can, we must make sure that we've got ample sources of liquidity and a stable core deposit base.

We've been hesitant to have any kind of a marketing campaign that focuses on attracting what I call "hot" money. We don't want to attract more unstable funding. We really are a consumer and small-business bank—a Main Street bank. So having stable operating business transaction accounts and checking accounts is really where our focus is. It's having good core deposits. We are a small-business bank, and that just lends well with our model, and it's an appropriate product.

—Dylan Clarkson, Pioneer Bank & Trust
Belle Fourche, South Dakota

Bankers' Perspectives:

There are a few things that we are doing from a recruiting perspective: We have found that many bankers are looking for a high-performing community bank where they are able to support their clients and help their clients achieve their goals without overly burdensome processes and policies that restrict their ability to be a good banker and a good risk manager. When they can find it in a growing organization with a strong relationship-based culture, they are eager to join. In addition to attracting talented bankers, we're also working at bringing new talent into the industry and new talent into our organization. We have experienced a higher level of retention issues, specifically a higher level of new people coming into the organization and then leaving in the first six months to a year. We are trying to understand what is causing this and elevate our focus on the upfront hiring and recruiting by providing a lot more clarity of the role that people are stepping into, the responsibilities they will have and the progression of that role. We are also elevating our training and development to ensure that those who are new to banking really feel prepared for the role; that they get gratification of performance and growth, as well as seeing progression in their responsibilities. While it's important that we are focused on development, it's also important that we are exciting them with career paths.

—Greg Hayes, Kish Bank
State College, Pennsylvania

The hiring process starts long before we see an application. The next generation of bankers is looking for companies that are interested in more than making money; they want to know they're making a difference in the world and that their work has purpose. Midwest BankCentre (MBC) has done tremendous work to communicate and share our purpose through both words and actions, with a concerted social media strategy that includes a partnership between human resources (HR) and marketing. This partnership enables consistent and cohesive messaging between the two areas that allows HR to leverage the work of the marketing group in recruitment. We have been told consistently that our orientation toward purpose is why new recruits are interested in MBC. They have seen us online, like what we stand for and want to try us out. This is a differentiator.

—Orv Kimbrough, Midwest BankCentre
St. Louis, Missouri

Additional Internal Risks

Compliance risk (excluding Bank Secrecy Act and consumer) and credit risk were seen by more than 69% of respondents as either "extremely important" or "very important" risks. Consumer compliance and fair lending risks were not too far behind, with 66% of bankers regarding them together as "extremely important" or "very important."

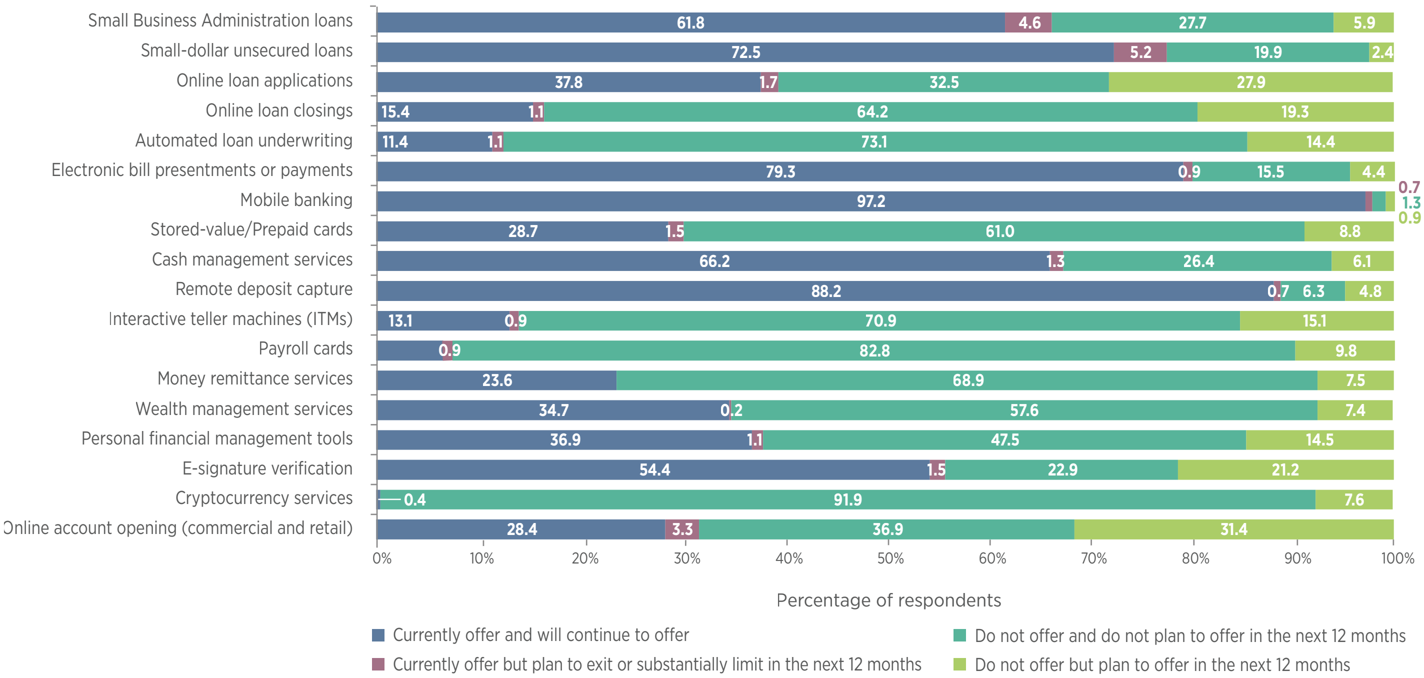
Roughly 62% of bankers viewed operational risk as either an "extremely important" or "very important" internal risk.

Leadership succession risk and market risk were ranked the lowest this year for internal risks.

Bankers cited several other internal risks in some of their narrative responses to the survey, including internal fraud and their ability to attract new talent to their institutions.

FIGURE 9

What are your institution's intentions regarding the following financial products or services?



Online banking remains a focal point for survey respondents, with 98% of survey respondents currently offering mobile banking, 89% offering remote deposit capture, and 80% providing online bill pay, or electronic bill payment and presentment. The share of banks providing e-signature verification increased from 50% in last year's survey to 56% this year. While only 32% of banks currently offer online account opening, an additional 31% plan to start offering this service in the next 12 months.

Online loan services were less common in this year's survey, with 40% of banks offering online loan applications and 17% offering online loan closings. These shares were down from 41% and 20%, respectively, in last year's survey. The share of banks offering small-dollar unsecured loans was close to last year's, with approximately 78% of banks currently offering these products.

The share of banks providing Small Business Administration (SBA) loans continues to trend downward, after reaching a peak of 77% in 2020 with the popularity of lending under the Paycheck Protection Program. The percentage of banks currently offering SBA loans fell to 66% this year from 71% last year.

The share of banks offering wealth management services rose to 35% in this year's survey, up from 33% last year. In addition, personal financial management tools are reportedly being offered by 38% of surveyed banks.

Surveyed banks showed little interest in offering cryptocurrency services, with nearly 100% of respondents reporting they are not currently offering these services, and 92% of those do not plan to offer them in the next 12 months.

TECHNOLOGY AND TECHNOLOGY SERVICES

Banks continue to navigate both existing and future banking technologies. Banks were asked whether they view existing technologies as an opportunity or a liability. Bank views were roughly split between those who viewed existing banking technologies as more of an opportunity than a liability (47%) and those who viewed them as both a liability and an opportunity equally (45%). Only a small share of banks viewed existing technologies as more of a liability than an opportunity (5%), and an even smaller share (4%) viewed them as neither an opportunity nor a liability.

On future banking technologies, banks were asked whether they viewed these technologies as an opportunity or a threat. Roughly half (50%) of respondents saw future banking technologies as both a threat and an opportunity equally, while 44% of respondents viewed these technologies as more of an opportunity than a threat. Only 5% of banks viewed future banking technologies as more of a threat than an opportunity, while just 2% viewed them as neither.

FIGURE 10

How does your bank view existing technology?

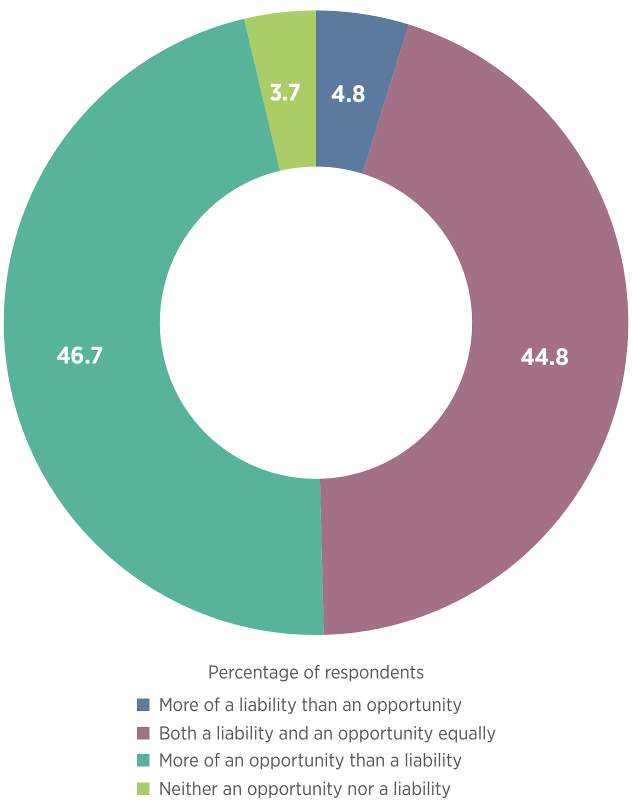


FIGURE 11

How does your bank view future technology innovation in banking?

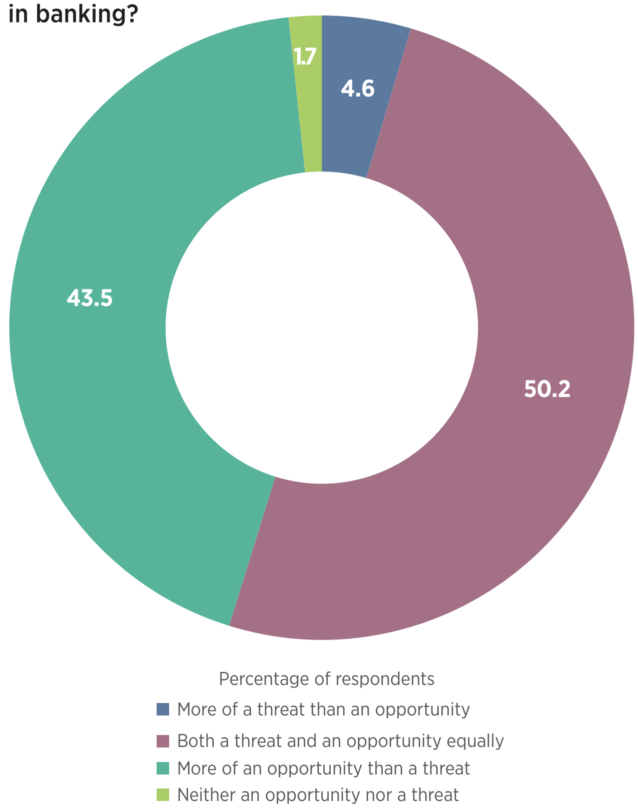
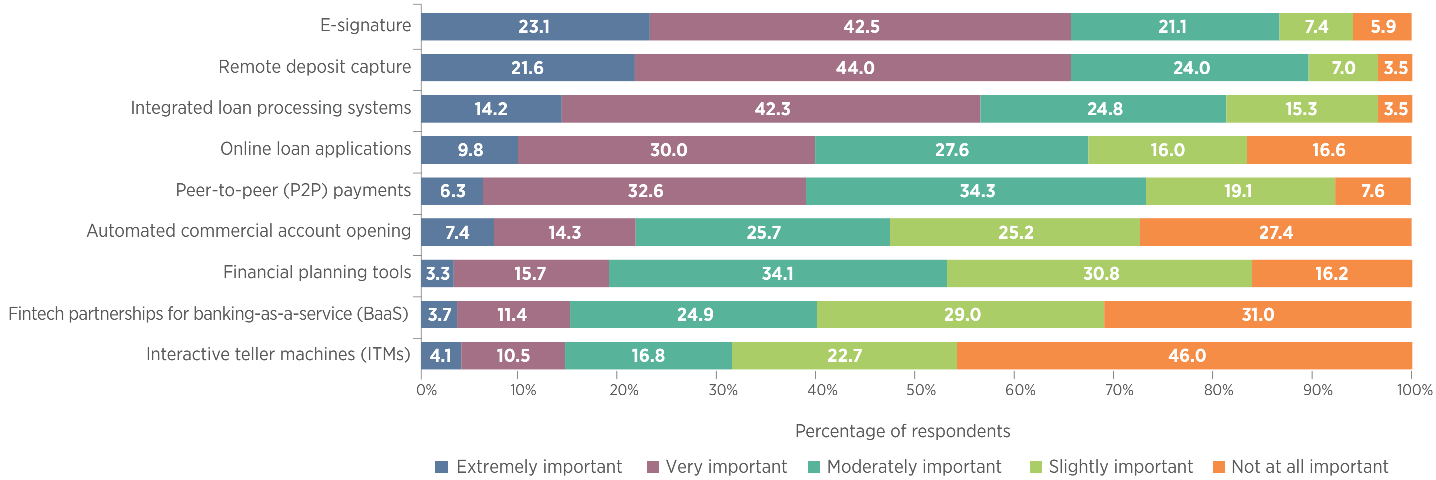


FIGURE 12

How important are the following technologies for your bank?



Additional Technology and Technology Services Findings

- Surveyed bankers viewed banking technologies such as e-signatures and remote deposit capture as the most important, with these categories receiving the largest share (more than 65%) of "extremely important" and "very important" classifications.
- Meanwhile, they identified integrated loan processing systems as an additionally important technology, with roughly 57% of respondents classifying this technology as "extremely important" or "very important."
- Bankers placed the least importance on technologies related to financial planning tools and interactive teller machines, as well as fintech partnerships for banking-as-a-service (BaaS).
- Bankers cited several other technologies as extremely important for their banks, which varied from consumer online account opening and mobile banking apps to solutions for fraud mitigation, risk management and regulatory technology.

New and emerging technologies are important tools for banks to meet customer demand. Nearly all bankers surveyed identified the adoption of new or emerging technologies as important, with 10% viewing them as "extremely important" and 49% as "very important." Less than 1% of respondents viewed the adoption of new or emerging technologies as "not at all important." Costs and implementation remain the largest impediments to adoption. Bankers identified limitations of core service providers as the second most significant barrier to adoption.

In their narrative responses, some bankers cited several other impediments to technology adoption, including:

- Educating or finding adequate staff to implement new and emerging technologies
- Changing internal procedures to accommodate new technology
- Regulator acceptance and expansion of their policies for reasonable oversight
- Lack of appetite for risk and lengthy evaluation processes

FIGURE 13

How important is the adoption of new or emerging technologies to meet customer demand in your market?

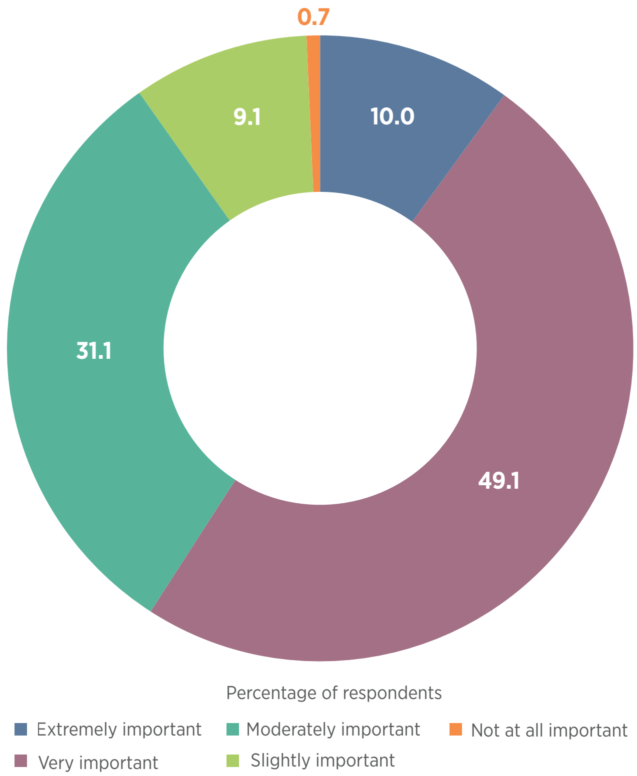


FIGURE 14

What is the most significant impediment to adopting new technologies?

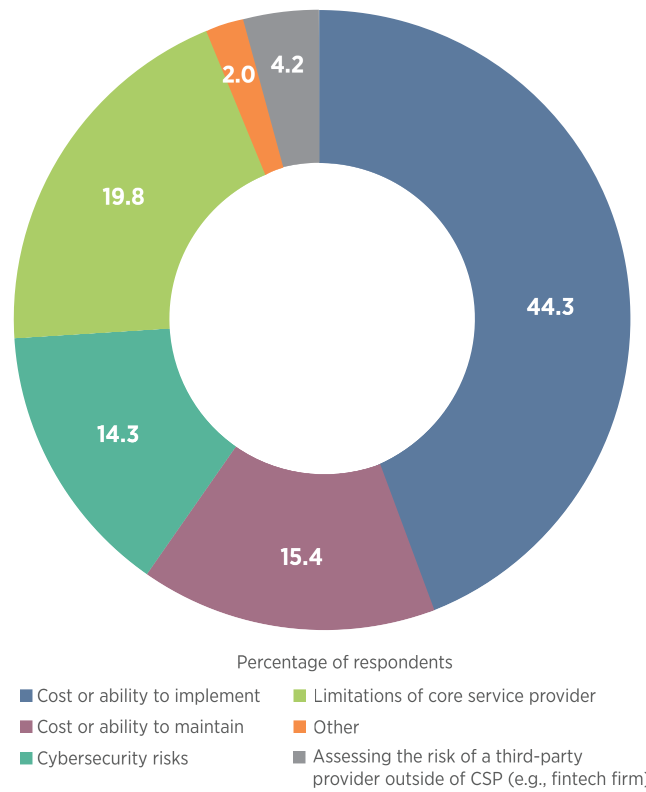
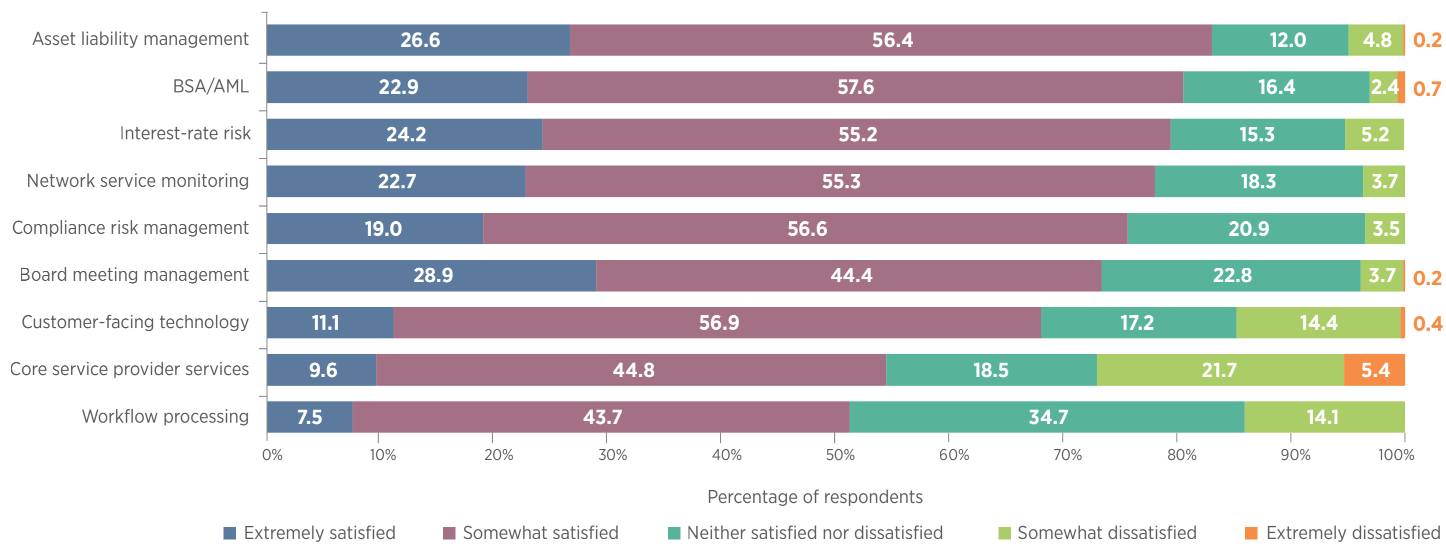


FIGURE 15

How satisfied are you with the effectiveness of your bank's technology in the following areas?



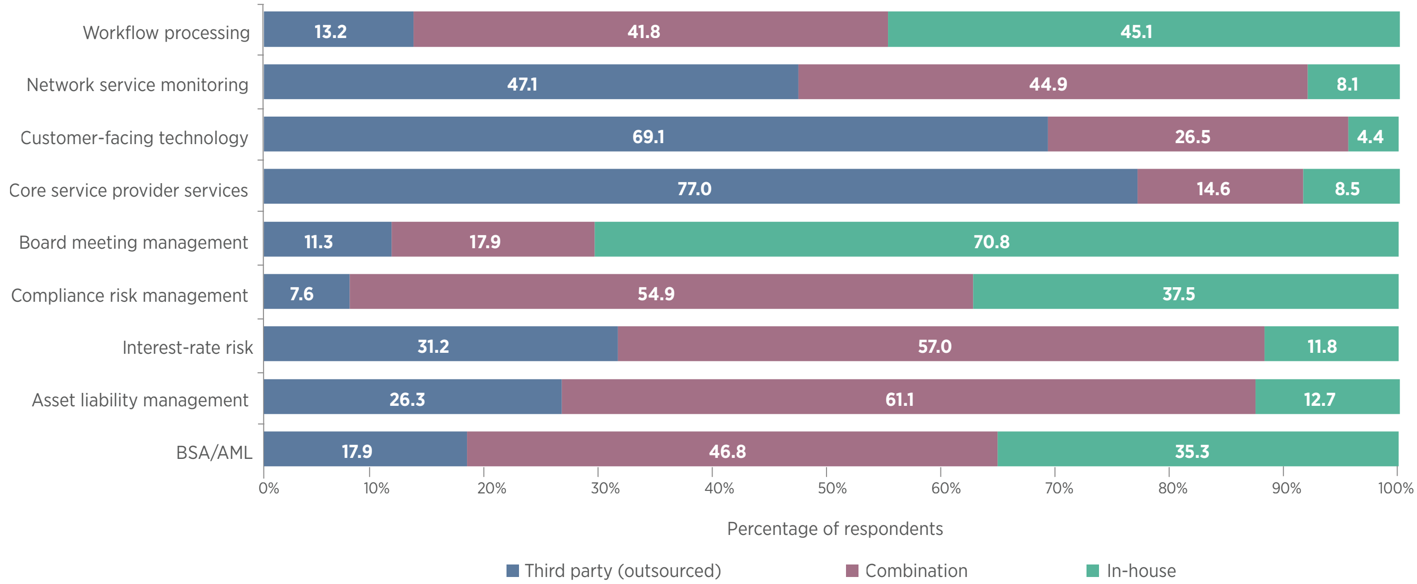
Bankers expressed the highest level of satisfaction when it came to the effectiveness of technology related to asset liability management and Bank Secrecy Act/Anti-money laundering (BSA/AML), with more than 80% noting they were either "extremely satisfied" or "somewhat satisfied" with the effectiveness of their technology in these areas.

More than 73% of respondents noted they were at least "somewhat satisfied" with technologies in areas such as interest-rate risk, network service monitoring, compliance risk management and board meeting management.

Meanwhile, they identified the lowest level of satisfaction in technologies related to core service provider services and workflow processing. These were the only two areas with less than 60% of banks expressing they were at least "somewhat satisfied."

FIGURE 16

How are your technology needs for the following services being met?

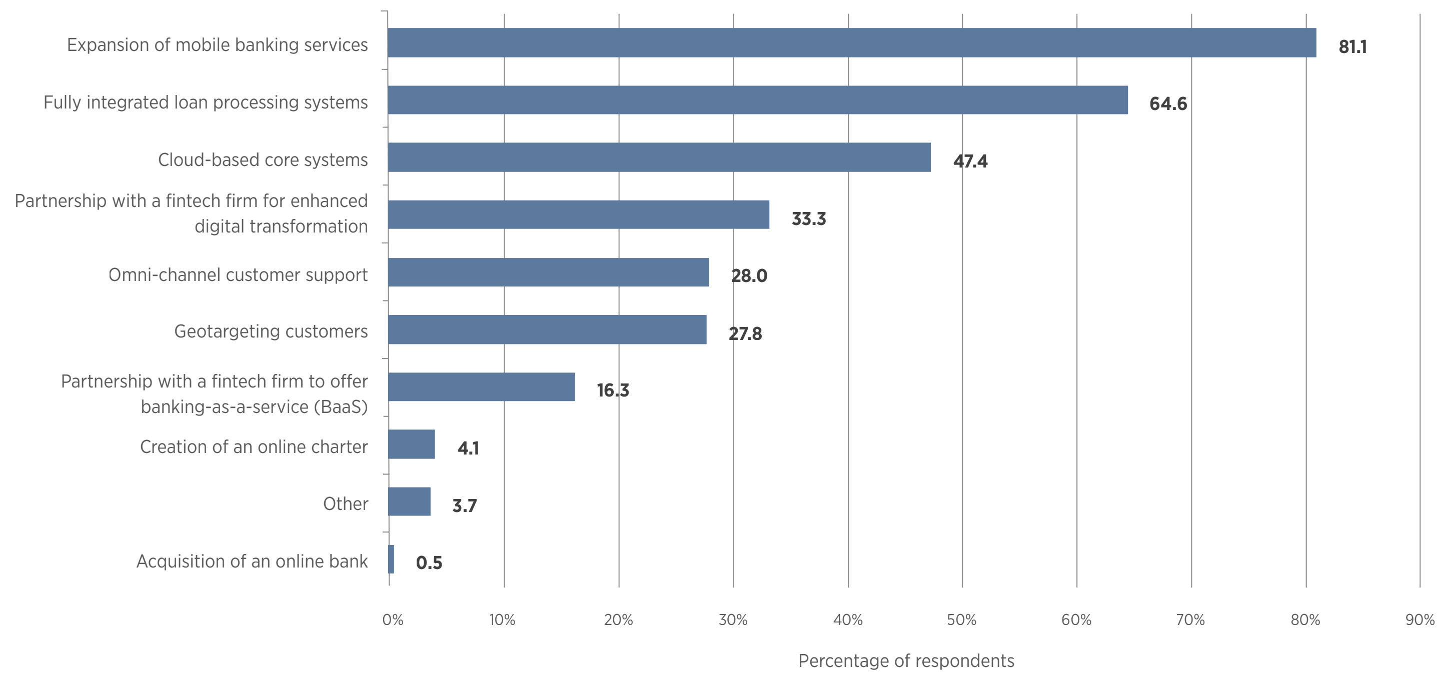


Core service provider services and customer-facing technology were the most common technologies being outsourced to third-party vendors, according to survey respondents. Surveyed bankers identified board meeting management and workflow processing as more likely to be done in-house.

Other services, such as asset liability management, interest-rate risk and compliance risk management, were commonly handled by a combination of third-party vendors and in-house.

FIGURE 17

What technological developments will be promising opportunities for your bank over the next five years?



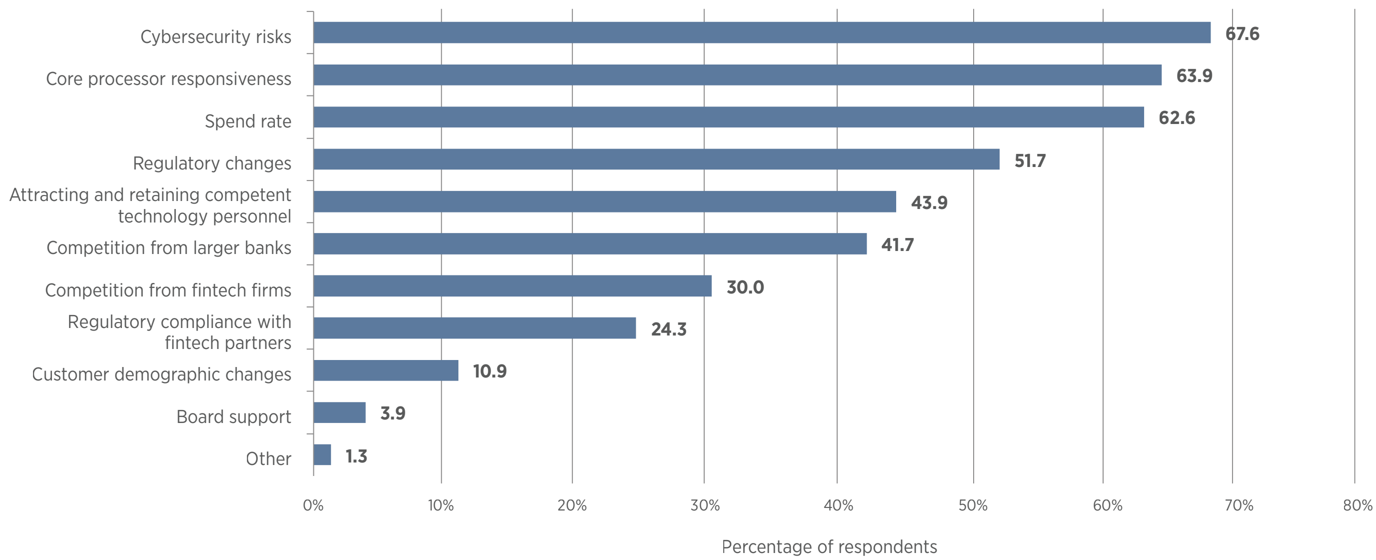
Looking ahead over the next five years, bankers showed the most optimism for technological developments related to expanding mobile banking services, with 81% of bankers identifying this as a promising opportunity for their banks. Nearly 65% of respondents viewed fully integrated loan processing systems as a promising opportunity, while 47% saw an opportunity in cloud-based core systems. In contrast, they saw little opportunity in areas related to the creation of an online charter or acquisition of an online bank.

In some of their narrative responses, community bankers cited several other promising technological opportunities over the next five years, including:

- Acquiring a financial services-related technology company
- Implementing in-house banking-as-a-service (BaaS) and software-as-a-service (SaaS) technology
- Offering open banking application programming interfaces
- Adopting artificial intelligence
- Offering online account openings for both deposits and loans
- Utilizing digital commercial lending

FIGURE 18

What do you see as the most difficult challenges to implementing new technology over the next five years?



Bankers expect cybersecurity risks to pose the most difficult challenges to implementing new technologies over the next five years, with 68% identifying them as such. Other commonly identified challenges include core processor responsiveness (64% of respondents), spend rate (63%) and regulatory changes (52%).

In some of their narrative responses, community bankers also listed several other impediments to technology implementation, including:

- Staff resistance to new technology
- Increasing fraud
- Criminal exploitation
- Risk of obsolescence

Bankers' Perspectives:

We no longer compete with the traditional banking brand. We compete with the technology brands that have banks standing behind them, and this adds a tremendous level of competition for the experience we provide—specifically, the experience we provide through technology. It's important that as we utilize that technology, we continue to expand the products and services to be competitive. We also understand that the ability to move money is getting faster and easier. With new technology, the speed of money movement in the financial system is getting more complicated for the average banking client. The threat of fraudsters trying to get access to their money is increasing every day. We understand that most people are looking for help in understanding what is going on, such as the new products and services that are available, whether something is safe or not, whether or not they should attach their debit card to their digital wallet and their phone. They just want the reassurance and confidence from someone they know and trust, and we want to be that local banker.

—Greg Hayes, Kish Bank
State College, Pennsylvania

FIGURE 19

How important is meeting customer cryptocurrency needs at your bank?

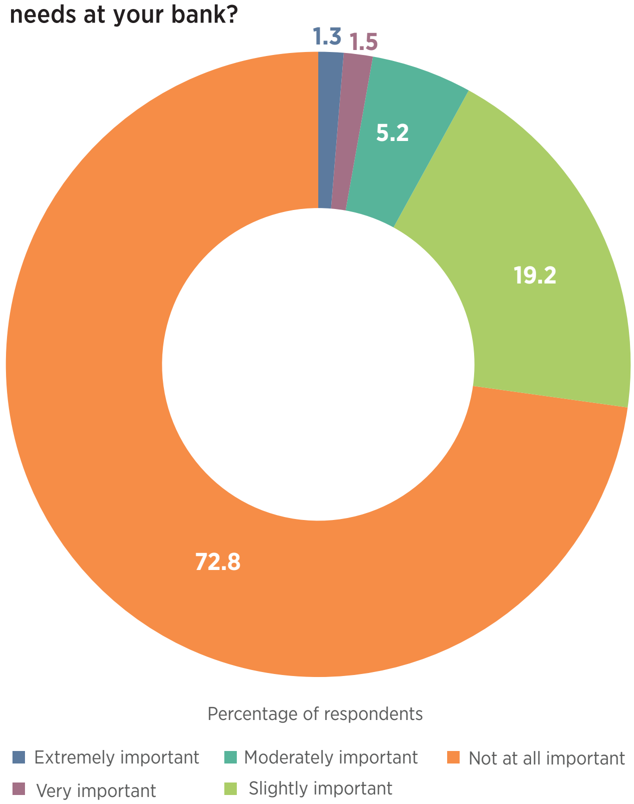
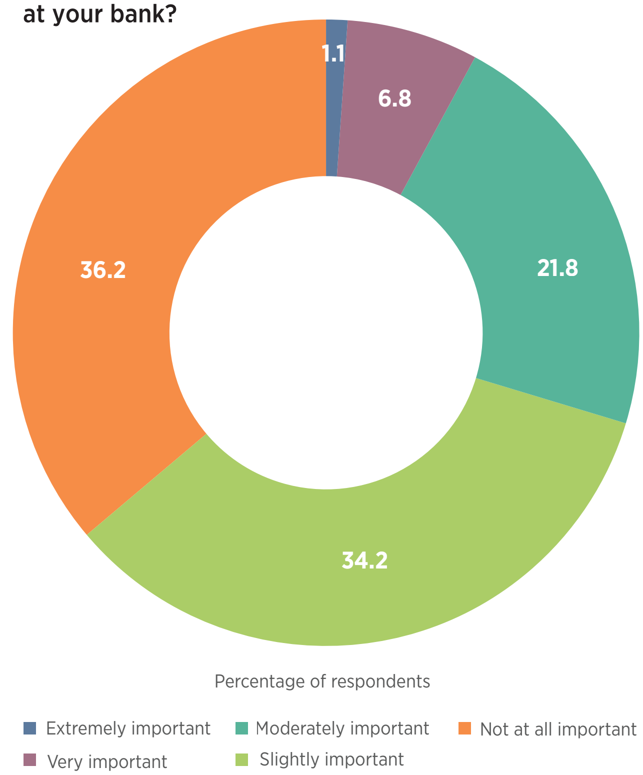


FIGURE 20

How important is the use of machine learning, natural language processing and other related technologies at your bank?



The majority of survey respondents (73%) reported that addressing the cryptocurrency needs of bank customers is not an important aspect of bank business. The percentage of community banks reporting addressing the cryptocurrency needs of customers as "not at all important" is up from 51% in last year's survey.

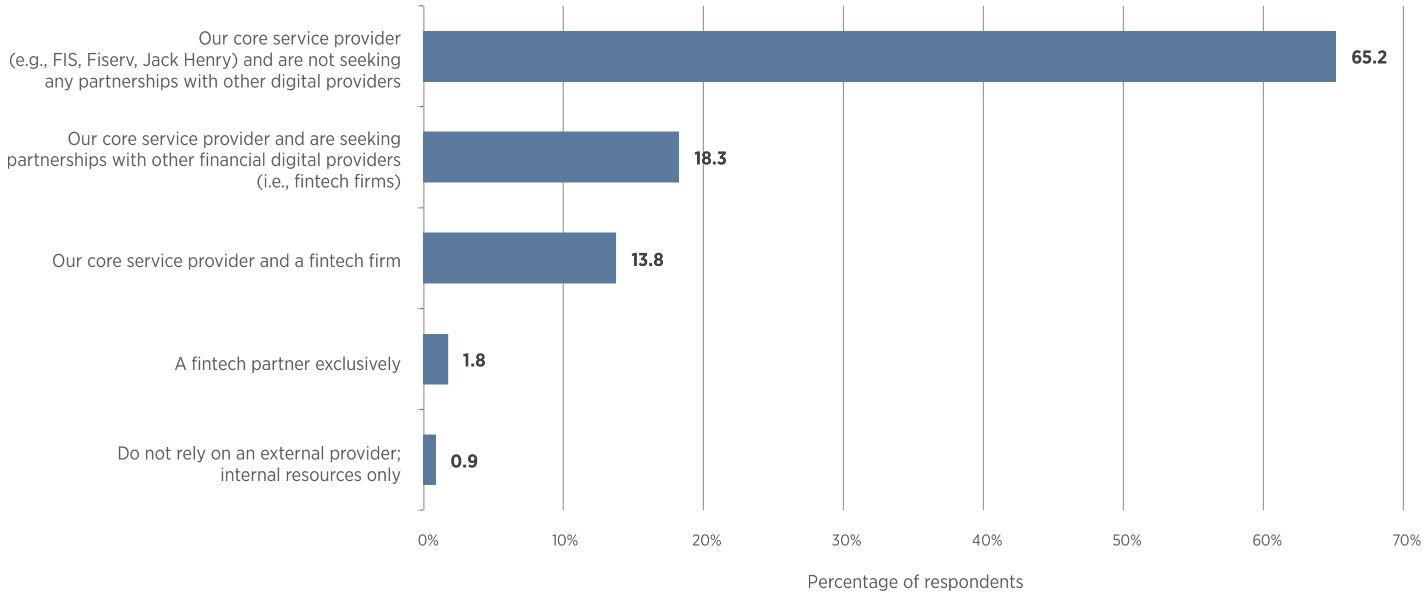
Machine learning, natural language processing or other related technologies fared better than supporting cryptocurrency needs, with 64% of respondents identifying this type of technology as at least "slightly important."

DIGITAL PLATFORMS, CORE SERVICE PROVIDERS AND FINTECH PARTNERS

Core service providers remain the primary source of digital banking products and services. Close to two-thirds of respondents reported relying on core service providers for digital banking products and services, and reported they were not seeking any partnerships with other digital providers such as fintech firms. Meanwhile, 18% of bankers identified using core service providers while also seeking partnerships with other financial digital providers. A smaller share, 14%, relied on both core service providers and fintech firms for their digital product and service offerings.

FIGURE 21

On whom does your bank rely for digital banking products and services?



Bankers' Perspectives:

In the future, while we will have to offer deposit products that are very competitive, we will also be forced to offer all of the technological advances that go with the products. We will be forced to create platforms comparable to those of fintech companies, which make it effortless for consumers and businesses to do their banking and move money around. For community banks, this will require core service providers to get on board with the necessary enhancements. At this point, the core service providers are not there yet; thus, the industry is handcuffed. I don't know how you can compete in this space without cooperation from the core providers.

—Brent Vidrine, Bank of Sunset and Trust Co.
Sunset, Louisiana

FIGURE 22

How satisfied is your bank with the following in-house core processing services?

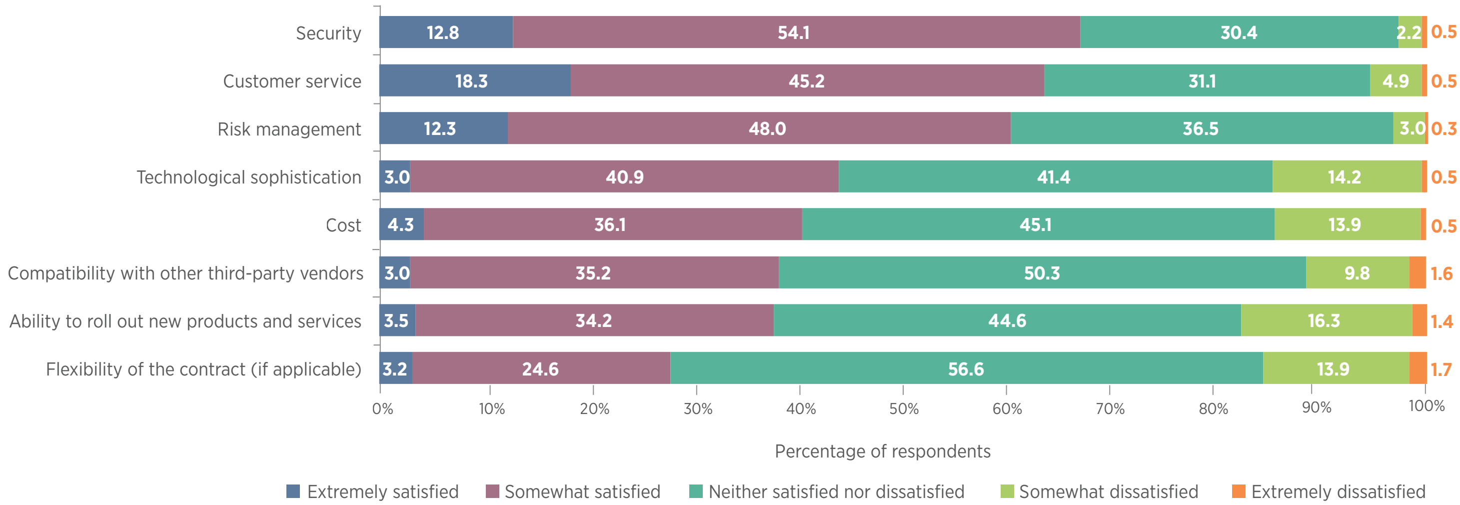


FIGURE 23

How satisfied is your bank with the following core processing services provided by an external company?

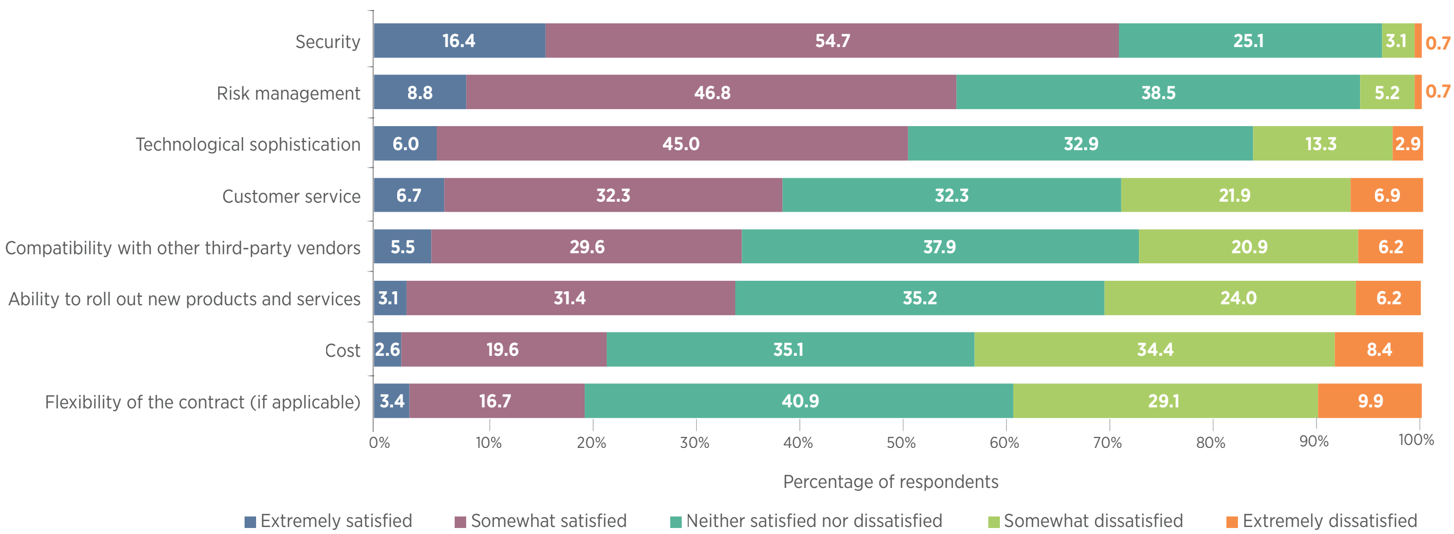
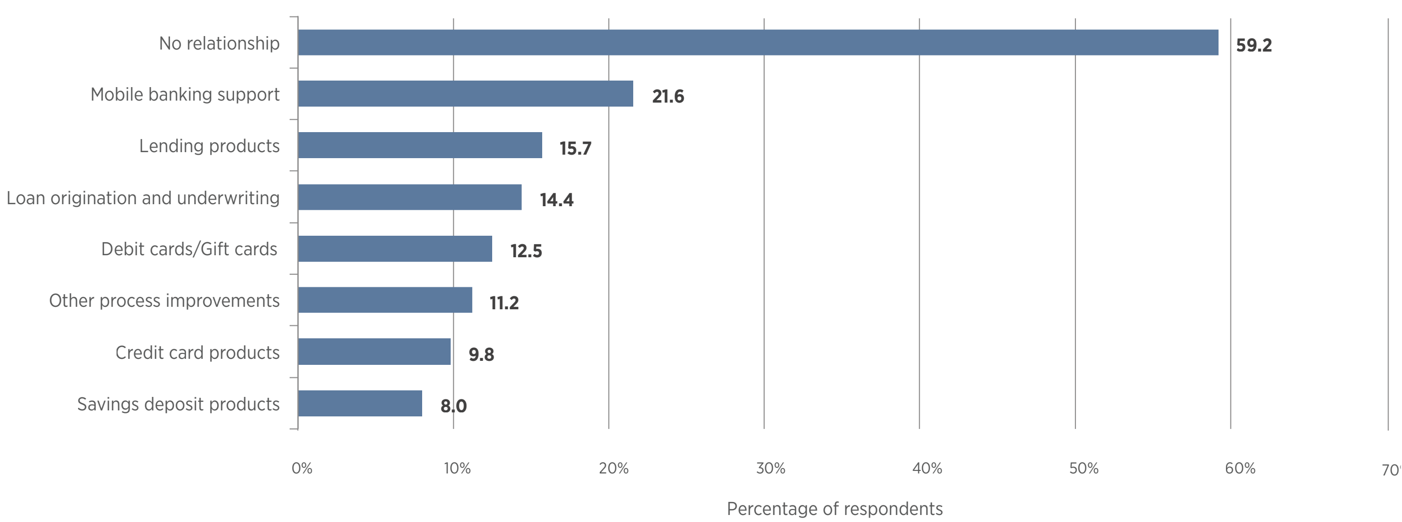


FIGURE 24

If you have a relationship with a fintech firm, what is the nature of the relationship?



Since last year, the number of community bank charters declined by approximately 3%, which is in line with an overall trend in charter consolidation that began in 1986 and continues today.[4] Despite the decline in charters, however, competition for banking products and services has only increased—particularly from other community banks—according to respondents to the 2023 annual survey.

In the face of considerable banking uncertainty in March and May 2023, it appears as though community banks may have experienced a retrenchment—more respondents reported other community banks as their primary competitor across seven of the nine product and service lines listed in the 2023 annual survey, and in much higher percentages than in recent years. By comparison, in 2022, community banks were viewed as the primary competitor across only six of the nine product and service lines in the survey.

A listing of the top community bank competitors across these nine product and service lines is shown in Table 1. A complete breakdown of how community banks experienced competition from community banks, regional and national banks, credit unions and nonbanks in 2023 can be found in Figures 25 and 26.

TABLE 1

Primary competition for community banks

Product or Service Line	Top Competitor 2023		Top Competitor 2022	
Wealth management and retirement services	Nonbank (in-market)	(40.5%)	Nonbank (in-market)	(34.4%)
Payment services	Regional or national bank (in-market)	(37.7%)	Regional or national bank (in-market)	(41.6%)
Non-transaction deposits	Community bank	(33.2%)	Community bank	(35.2%)
Transaction deposits	Community bank	(47.5%)	Community bank	(45.0%)
Small-dollar unsecured loans	Community bank	(40.3%)	Credit union	(32.4%)
Agricultural loans	Community bank	(47.6%)	Community bank	(36.9%)
1- to 4-family mortgage loans	Community bank	(30.4%)	Community bank	(23.8%)
Commercial real estate loans	Community bank	(52.0%)	Community bank	(43.8%)
Small-business loans	Community bank	(62.4%)	Community bank	(56.1%)

Community banks increasingly compete primarily with other community banks for most product and service lines, but particularly for small-business loans.

Most community banks compete with one another for small-business loans, but the share of community banks that indicated that other community banks were their primary competitors for these loans increased by more than 6 percentage points since 2022. It is also notable that more community banks viewed other community banks as their primary competitors for small-dollar unsecured loans—a business line that, prior to 2023, was increasingly the domain of credit unions. Community banks have, in prior years, lamented what they saw as increasing competition for small-business loans from credit unions. However, in 2023, the percentage of community banks naming credit unions as their primary small-business loan competitors actually declined by nearly 2 percentage points.

Community banks experienced a retrenchment of deposits, particularly for transaction deposits, in 2023.

There was significant attention on deposit flows, particularly after the failure of three prominent regional banks in March and May 2023. The impact on consumer and business deposits from these episodes was evident in the annual survey: 48% of community banks named other community banks as their primary competitors for transaction deposits in 2023—a 3-percentage-point increase from 2022. For non-transaction deposits, there was a slight decline in the number of community banks that viewed other community banks as their top competitors, while there was a slight uptick in those who named in-market regional or national banks as their top competitors. The survey data suggest that the events of spring 2023 may have supported an overall retrenchment of deposits in community banks in the face of uncertainty surrounding the health of some regional U.S. banks.

Community banks appear to have regained more of their competitive edge for agricultural loans against nonbanks (i.e., Farm Credit System).

In 2023, 48% of community banks named other community banks as their primary competitor for agricultural loans, an increase of nearly 11 percentage points over 2022. Several bankers reported that the rising-interest-rate environment was pricing the Farm Credit System out of the market in some instances. In the 2022 survey, the primary competitor for agricultural loans was more evenly split, with slightly more community banks naming other community banks or regional or national in-market banks as their primary competitors versus nonbanks—a difference of only 7 percentage points.

Commercial real estate lending is still the domain of community banks.

Competition for commercial real estate (CRE) loans shifted strongly toward community banks in 2023; 52% of community banks said their primary competitor was another community bank for these loans, compared with 44% in 2022. At the same time, nearly 42% of community banks viewed regional and national banks as their primary competitors for CRE loans in 2023, compared with 46% in 2022. While commercial real estate has been a long-standing core line of business for community banks, it is also an area of additional focus for regulators. On July 6, 2023, the Federal Reserve Board of Governors, the Federal Deposit Insurance Corp. (FDIC), the National Credit Union Administration and the Office of the Comptroller of the Currency issued a final policy statement on commercial real estate loan accommodations and workouts.[5]

Bankers' Perspectives:

Loyalty that once existed in banking is eroding. All banks will be faced with challenges in raising and retaining deposits, as some consumers elect to move their accounts to the largest financial institutions deemed to be too big to fail, as well as fintechs and nontraditional competitors. The latter are intensifying competition for deposits by offering technology-driven solutions with attractive rates and seamless digital experiences that appeal to modern customers, particularly younger demographics. To compete, community banks will have to adopt technology and the right level of intensive personal service to improve the customer experience. Community banks are the lifeblood of local communities and serve as the engine supporting economic growth.

Even so, many customers can have short-term memories about the importance of these institutions. Over the past four years, MBC has intentionally invested in setting up the systems to support online deposit account opening and loan applications to improve the customer experience. We believe competition for deposits and loans will continue to increase and pose challenges across the industry. This said, MBC is doubling down on our "bank local" message and our strength in relationship banking, delivering high-tech and high-touch customer experiences that serve the toughest markets and Main Streets in St. Louis and beyond.

—Orv Kimbrough, Midwest BankCentre
St. Louis, Missouri

We're one of the most heavily banked towns in all of Montana as far as I know. Eagle Bank is located in Polson, Montana, where we have six major financial institutions, and we have a population of roughly 5,500 people; that's roughly 900 people per bank. Helena, Montana, in comparison, has 40,000 people and 14 banks; that's roughly 2,850 people per bank. So we're exceptionally overbanked. It's really hard for me to compete with the two biggest banks and the biggest credit union in our state in terms of consumer deposits. And we're certainly not going to do it on price. If we're going to do it, it's going to be on service, because we're smaller, we're flexible and we're nimble, and we have what I believe to be really exceptional customer service. It's impossible for me to go up against any of the bigger banks with regard to buying the business in terms of selling deposits at really high rates or whatever it is that they have the ability to do, because they have way more product lines than I do.

To my knowledge, we are the only bank in the state of Montana that has discontinued the practice of charging overdraft fees, and this may help us some. In fact, not only have we stopped charging overdraft fees, but all of our business accounts have no credits and no per-item charges. The idea is to simplify everything, so everyone understands it, and it's very easy to work with. So we may see some migration.

—Andrew West, Eagle Bank
Polson, Montana

FIGURE 25

Who is your primary competitor for the following products and services?

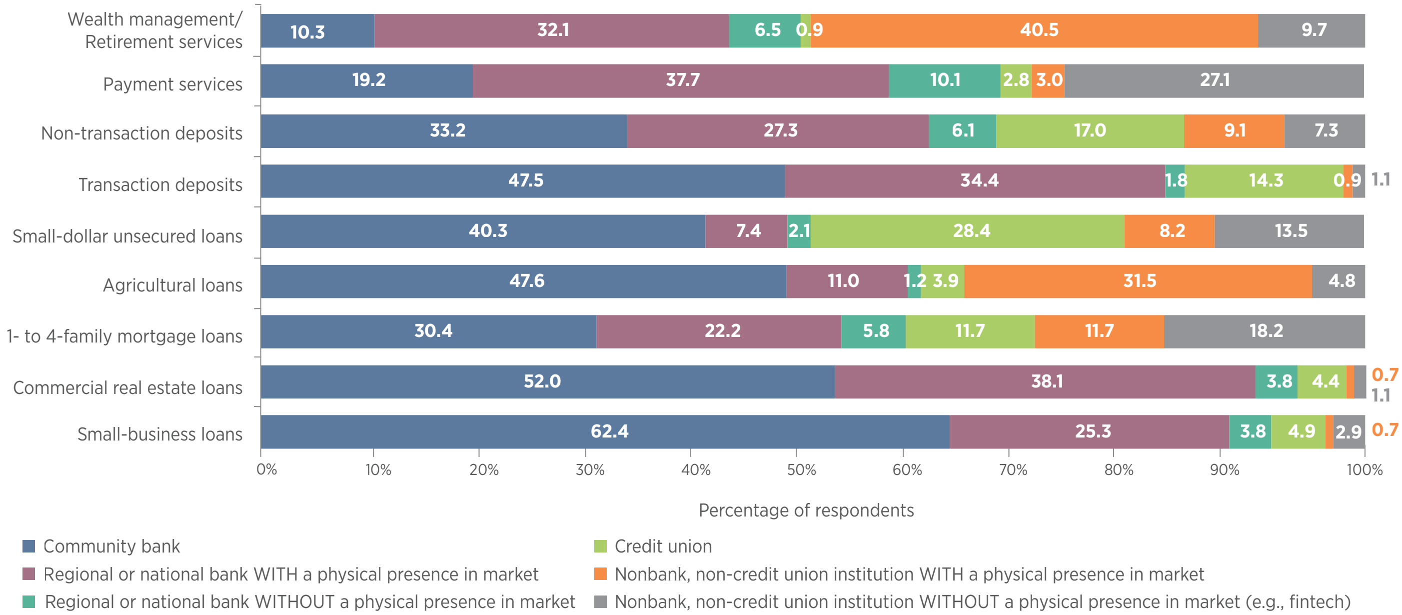
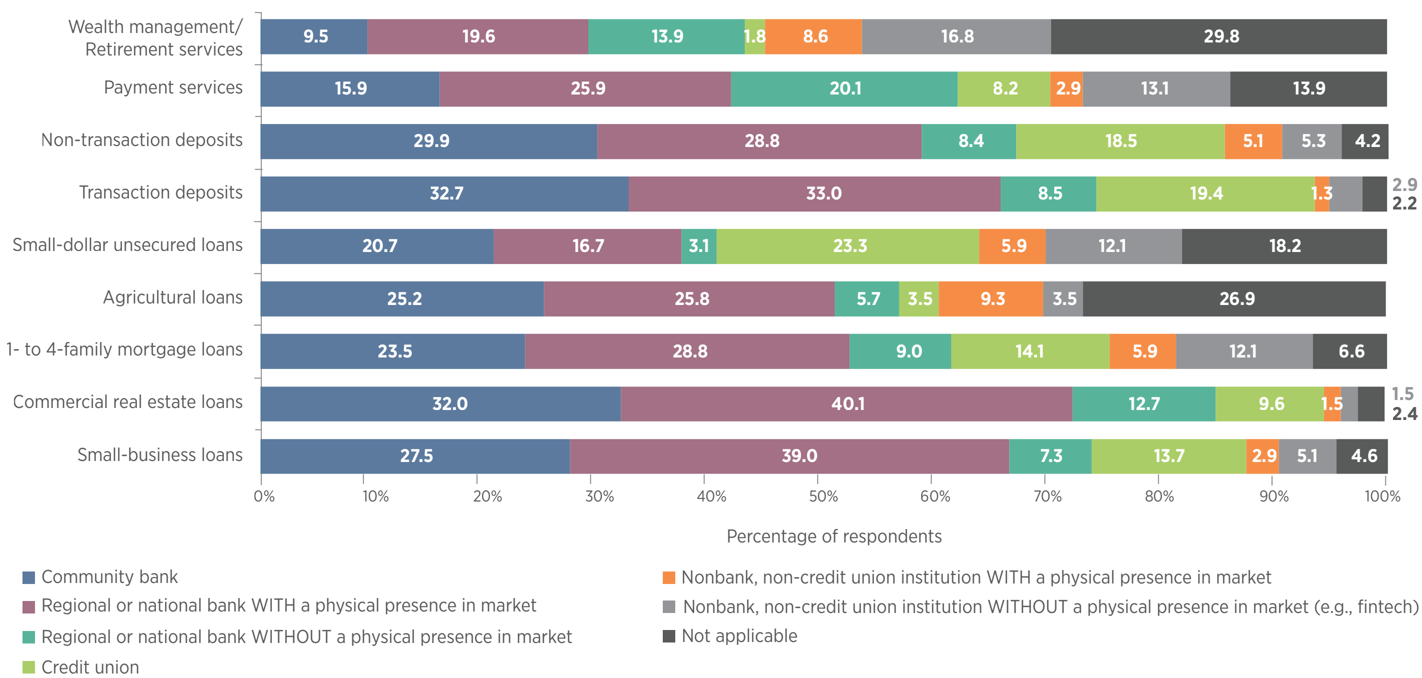


FIGURE 26

Who is your secondary competitor for the following products and services?



Community bankers also answered questions on how competition for deposits and loans impacts their pricing decisions. Reflecting, perhaps, the rising-interest-rate environment that began in March 2022 and continued through 10 consecutive meetings of the Federal Open Market Committee (FOMC) to May 2023 (with another rate increase in July 2023), 28% of bankers indicated that they "always" respond to changes in local market rates on deposits, up from 20% in 2022.

FIGURE 27

How often does your bank respond to changes in local market rates on deposits?

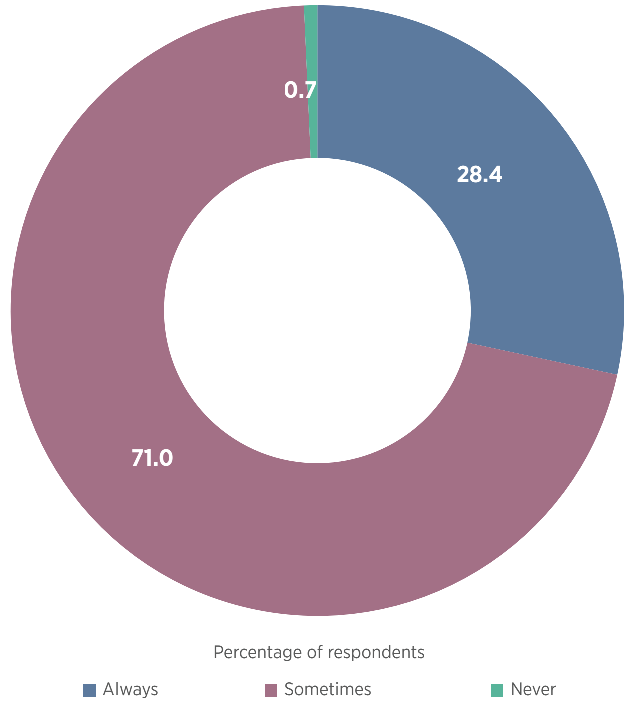
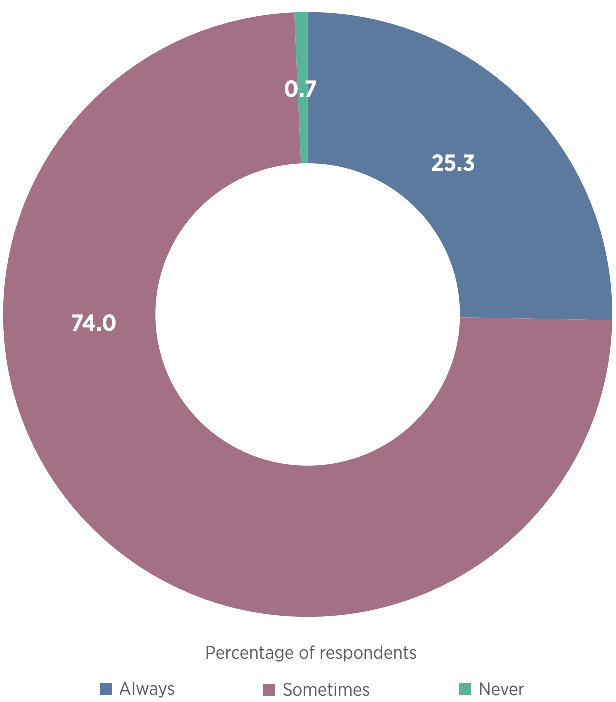


FIGURE 28

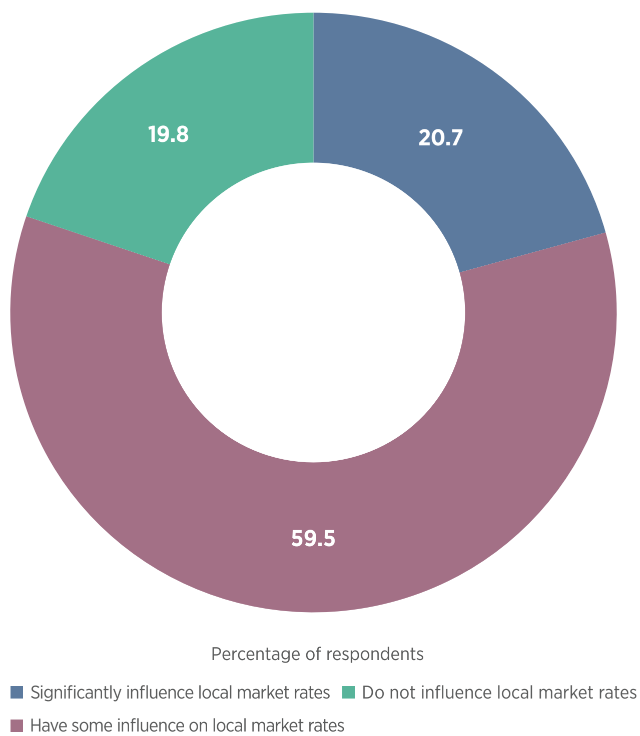
How often does your bank respond to changes in local market rates on loans?



Regarding how often their banks respond to changes in local market rates on loans, 25% of bankers responded "always," while 74% responded "sometimes." In 2022, they responded 24% and 75%, respectively.

FIGURE 29

How do your bank's pricing decisions on loans and deposits influence local market rates?



In terms of whether their pricing decisions influence local market rates, 21% of bankers reported they "significantly influence local market rates," and 60% reported they "have some influence on local market rates." This compares with 17% and 61%, respectively, in 2022.

Small-business lending remains a critical component for community banks, as shown in Table 2. The data show small-business loans composed of nonfarm, non-residential, and commercial and industrial loans of $1 million or less by banks with assets less than $10 billion (community banks), compared to banks with total assets greater than $10 billion. As of Dec. 31, 2022, small-business loans comprised 8% of total assets at community banks, compared to only 2% at the larger banks. Even though this share of assets has trended down in recent years, it still remains significant. The table shows that the average loan size at community banks significantly varies year to year, from $100,100 in 2019 to $68,900 in 2021, and then back up to $84,400 in 2022. Nevertheless, it remains notably larger than that of noncommunity banks. For example, the average loan size as of Dec. 31, 2022, for community banks was $84,400, compared with $16,700 at larger banks. One likely reason for this disparity is because larger banks tend to make more high-volume, low-value credit card loans compared to community banks. This is supported by Figures 30 and 31, where respondents noted that they were more likely to have smaller transactional loans compared to relational small-business loans in the future; the vast majority of respondents noted that these loans do not include any business credit card-related debt.

TABLE 2
Loans to small businesses

	Community Banks				Noncommunity Banks			
	Dec. 31, 2019	Dec. 31, 2020	Dec. 31, 2021	Dec. 31, 2022	Dec. 31, 2019	Dec. 31, 2020	Dec. 31, 2021	Dec. 31, 2022
Dollar amount	**$250.5**	**$324.3**	**$275.0**	**$269.8**	**$321.4**	**$431.6**	**$346.4**	**$359.2**
% of assets	**9.7%**	**11.0%**	**8.6%**	**8.1%**	**2.2%**	**2.5%**	**1.8%**	**1.8%**
Number of loans	**2,504**	**3,786**	**3,990**	**3,198**	**17,061**	**18,945**	**18,597**	**21,550**
Average loan size	**$100.1**	**$85.7**	**$68.9**	**$84.4**	**$18.8**	**$22.8**	**$18.6**	**$16.7**

NOTES: Dollar amounts are in billions of dollars. Numbers of loans are in thousands. Average loan sizes are in thousands of dollars.
Data are obtained from *Call Reports* published by the Federal Financial Instituitions Examination Council.

Relationship lending remains critical to the success of community banks and small businesses.

In Figure 30, bankers in the CSBS annual survey noted that they expected relationship-based lending to grow more than transactional lending in the future, similar to last year's findings.

FIGURE 30

In the future, what do you expect your bank's dollar volume to be on transactional small-business loans compared to relational small-business loans?

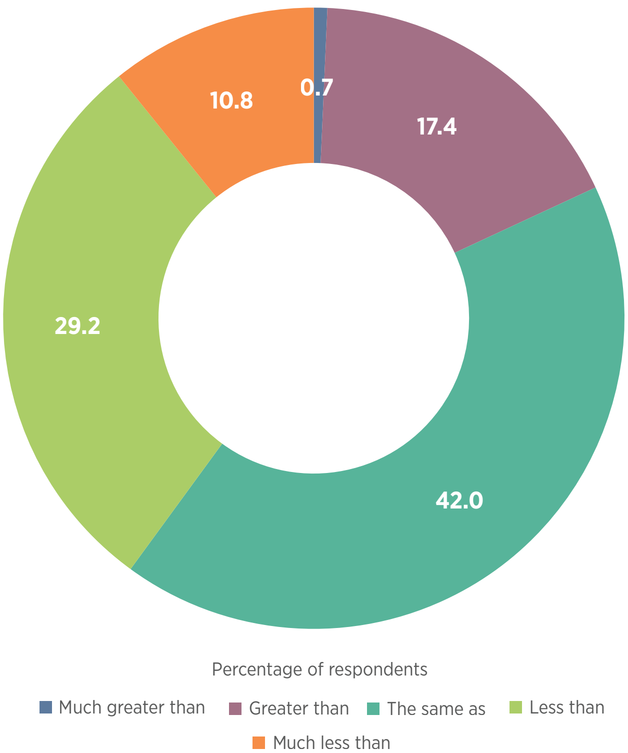
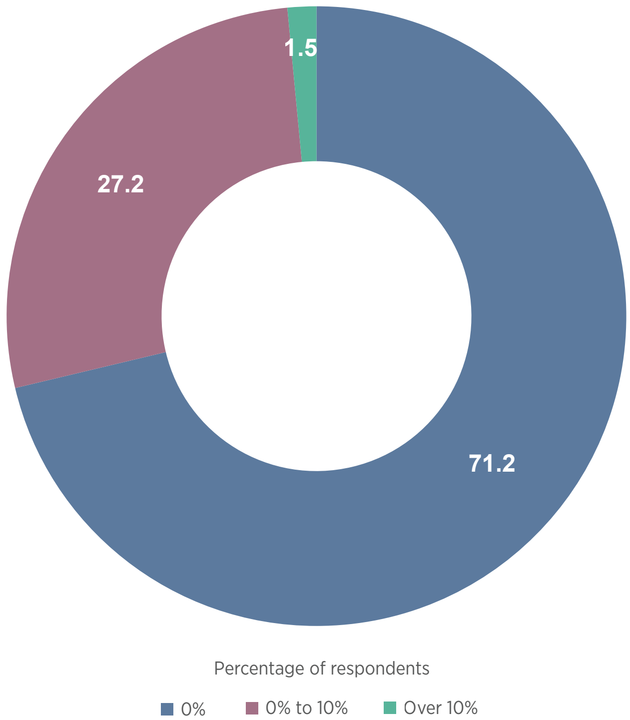


FIGURE 31

At your bank, what is the percentage of small loans to businesses (as defined in the *Call Report*) that are accounted for by business credit cards?



FUNDING

The liability side of community bank balance sheets was transformed over the last few years, as banks were flooded with COVID-19 pandemic deposits. However, the growth of deposits appears to have plateaued and even fallen slightly in recent months. Meanwhile, loan demand has remained strong, creating serious liquidity challenges for some community banks. As a result, banks have had to rely more heavily on various wholesale funds, such as brokered deposits, Federal Home Loan Bank (FHLB) advances, and other borrowings, as shown in Table 3. For example, brokered deposits were at $142 billion as of March 31, 2023, up 16% from Dec. 31, 2022, and up more than 105% from Dec. 31, 2021.

Similarly, FHLB advances and other total borrowings have approximately doubled in a little over a year. This comes at a time when interest rates are the highest they've been since prior to the 2008-2009 Great Recession. Table 4 shows how dramatically the funding costs have spiked in recent years, reflecting the challenges that banks face in retaining deposits and paying for funding overall. This will likely result in compression in net interest margins if banks aren't able to pass funding costs on to borrowers.

The turmoil caused by the failures of Silicon Valley Bank and Signature Bank in March 2023 also highlighted the vulnerability of banks that rely heavily on uninsured deposits. While there were other factors at play, such as underwater investment portfolios caused by rising interest rates and a panic by the banks' depositors exacerbated by social media, these failures certainly brought funding back in the spotlight. They highlighted the concentration risk of large, uninsured depositors, a phenomenon not typically seen in small community banks. Furthermore, the FDIC proposed a special assessment fee of 12.5 basis points (or 0.125%) of an institution's estimated uninsured deposits reported as of Dec. 31, 2022, adjusted to exclude the first $5 billion in uninsured deposits. The special assessment is designed to replenish the Deposit Insurance Fund that lost $15.8 billion due to the protection of uninsured depositors during these failures. Notably, this exclusion essentially exempts community banks, because community banks typically do not have $5 billion or more in uninsured deposits.

TABLE 3

Wholesale funds

	Dec. 31, 2019	Dec. 31, 2020	Dec. 31, 2021	Dec. 31, 2022	March 31, 2023
Brokered deposits	**$83.6**	**$85.9**	**$69.4**	**$122.3**	**$142.4**
Federal Home Loan Bank advances	**$99.4**	**$80.5**	**$60.8**	**$122.3**	**$129.7**
Other borrowed money (total)	**$106.8**	**$112.0**	**$77.8**	**$137.0**	**$154.9**
Fed funds purchased and repurchase agreements	**$24.7**	**$26.0**	**$24.5**	**$28.5**	**$27.0**
Listing service deposits	**$20.4**	**$20.8**	**$16.7**	**$16.5**	**$17.0**

NOTES: Dollar amounts are in billions and collected quarterly for community banks.
Data are obtained from *Call Reports* published by the Federal Financial Institutions Examination Council.[6]

TABLE 4

Cost of deposits and funding

	Dec. 31, 2019	Dec. 31, 2020	Dec. 31, 2021	Dec. 31, 2022	March 31, 2023
Cost of deposits	**1.09%**	**0.71%**	**0.37%**	**0.56%**	**1.49%**
Cost of funds	**1.16%**	**0.75%**	**0.41%**	**0.62%**	**1.65%**

NOTE: Percentages are the average cost of deposits and overall funds for community banks as reported in the *Call Report.*

FIGURE 32

How important are each of the following potential challenges to attracting and retaining core deposits?

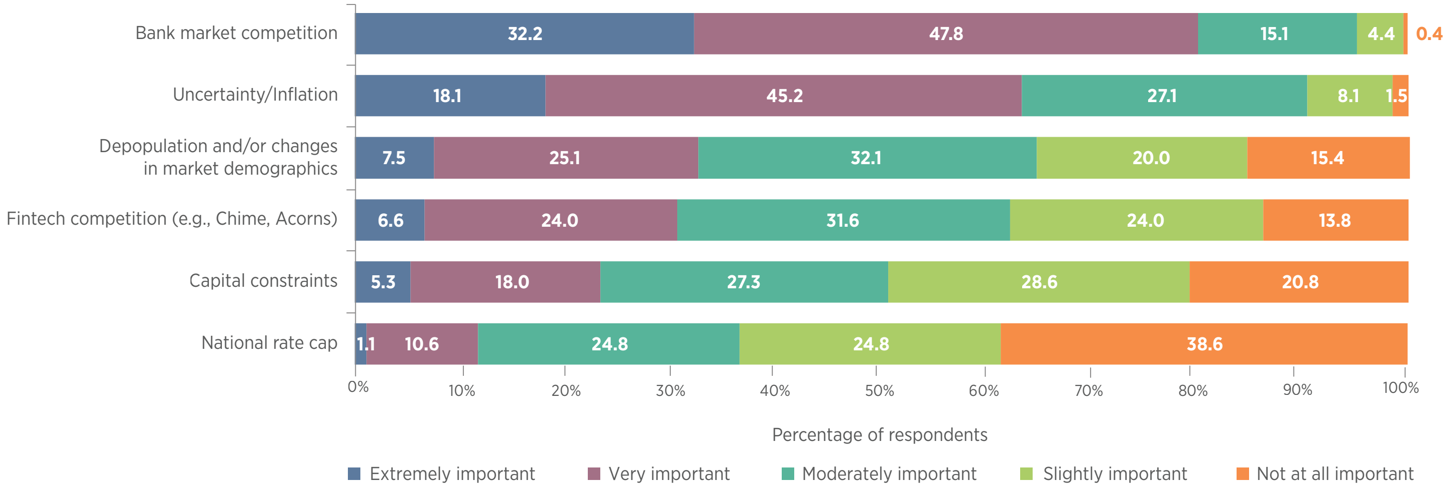
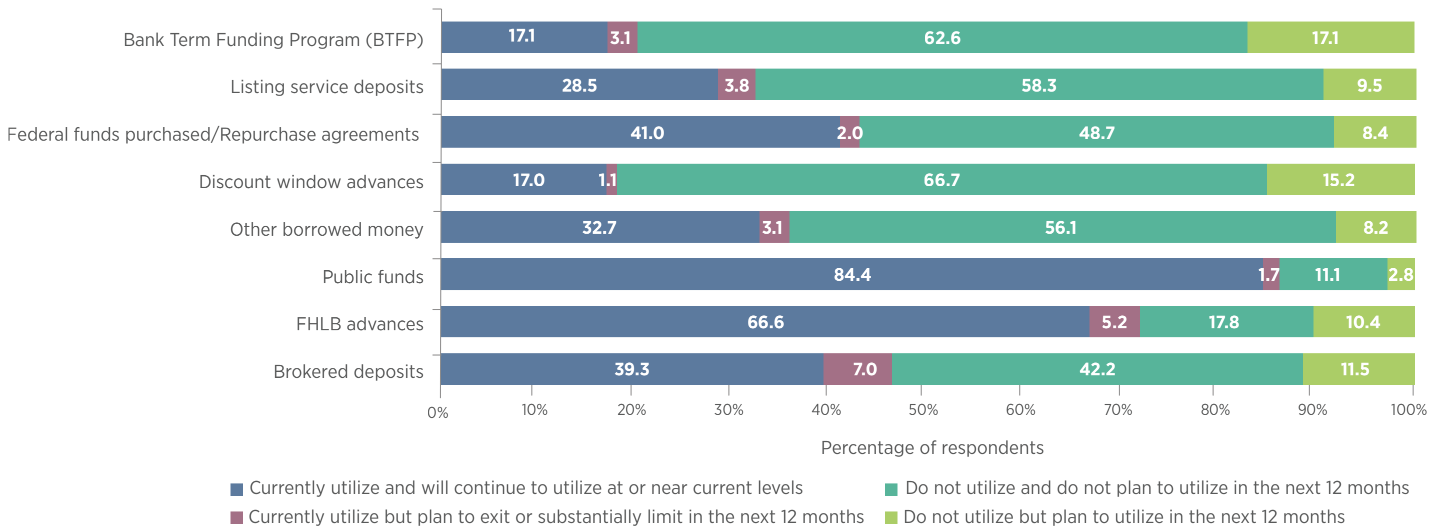


FIGURE 33

What are your institution's intentions regarding the following wholesale funding sources?



Figures 32 and 33 highlight the stresses banks are facing in funding, as observed in the *Call Report* data shown in Tables 3 and 4.

Bank competition and uncertainty/inflation are the biggest challenges and hurdles that banks are facing in attracting and retaining core deposits, while the national rate cap, capital constraints and fintech competition are considered less likely to be impediments. This year, the Federal Reserve introduced a new temporary liquidity program called the Bank Term Funding Program, designed to restore confidence in the aftermath of the March bank failures. It became popular right away, with 20% of survey respondents saying they currently utilize it. However, more than 80% of respondents noted they currently do not utilize the program and 63% do not plan to do so over the next 12 months. This could indicate that the need for the program has subsided. This finding could also reflect stigma related to its use.

Similar to last year, community bankers relied most often on public funds and Federal Home Loan Bank advances as sources of wholesale funds. Fed funds purchased and brokered deposits also continue to be popular with many banks as alternate sources of funding.

Besides public funds, bankers continue to rely on FHLB advances, brokered deposits, and Fed funds purchased and repurchase agreements as the "go to" sources of wholesale funding. This is consistent with the data shown in Tables 3 and 4 and highlights the cost of funding pressures banks are facing in this high-interest-rate environment.

In late July, the Federal Reserve System, FDIC, Office of the Comptroller of the Currency and the National Credit Union Administration issued an "Addendum to the Interagency Policy Statement on Funding and Liquidity Risk Management: Importance of Contingency Funding Plans,"[7] in part to assuage industry stigma concerning the Federal Reserve's discount window. The updated guidance highlights that depository institutions should regularly evaluate and update their contingency funding plans and encourages depository institutions to incorporate the discount window as part of these plans. Consistent with other contingency funding sources, the guidance reinforces the supervisory expectation that if the discount window is part of a depository institution's contingency funding plans, the depository institution should establish and maintain operational readiness to use the discount window, which includes conducting periodic transactions.

Bankers' Perspectives:

For the foreseeable future, we're going to continue to battle it out for deposits. There's no question. There are a lot of competitive pressures out there. With loan demand still fairly strong, we'll have to continue to be very proactive in managing liquidity. In addition, we'll have to manage interest-rate risk. Wholesale funding has become very important to institutions. Banks are tapping into those sources, and it will be a viable product for the foreseeable future. Our institution is not going to be an exception. We will have to take advantage of the products offered by the Federal Home Loan Bank, the [Bank Term Funding Program] and the Fed discount window or other options. However, with a projected recession on the horizon, depending on the severity and if it is a hard or soft landing, the funding/liquidity landscape may change significantly over the next year or so.

—Brent Vidrine, Bank of Sunset and Trust Co.
Sunset, Louisiana

Most community banks depend on deposits and loans for their business. Not only are we seeing alternative places to secure loans proliferate, but we are also seeing consumers place deposits in emerging platforms like Apple, which generated more than $1 billion in deposits within its first four days, further reducing the dollars in circulation for community banks.

Deposit growth will be a challenge in the coming years for community banks that depend on everyday consumers and poses an existential threat to our future. Over the past few years, MBC has optimized the balance sheet and cost of funds by running near a 100% loan-to-deposit ratio. Over the past 12 months, MBC has implemented a variety of deposit growth strategies, thereby reducing the loan-to-deposit ratio to approximately 93%. MBC's five-year forecast includes deposit growth strategies to further reduce the loan-to-deposit ratio to 85% and shift the mix of deposits by increasing non-maturity deposits to further reduce reliance on certificates of deposit (CDs) and wholesale funding. Our focus will be on markets where there will be barriers to entry for big-tech, emerging industries that need strong treasury management functions and leveraging more deeply our mission-purpose and advantages in being hyper-local.

Additionally, Rising Bank, MBC's digital branch, has proven to provide a competitive advantage over others seeking liquidity by building a nationwide channel for sticky deposit growth. Rates paid on deposits raised through this channel are higher than rates paid in our lower-cost brick-and-mortar branches, although they are historically below brokered CD rates and Federal Home Loan Bank advances. The flow of deposit growth can be turned up or down depending on deposit gather and liquidity needs.

—Orv Kimbrough, Midwest BankCentre
St. Louis, Missouri

LOAN PARTICIPATIONS

Loan participation can serve as an important mechanism for banks that are near their legal lending limit to continue supporting the lending needs of their larger core customers. Participation can also serve as a source of loan diversification and risk mitigation for community banks. In 2023, the majority of respondents reported that fewer than 5% of all loans bought and sold are participations.

This dearth of loan participation activity could reflect that loan demand has generally been ample for banks and manageable within most banks' legal lending limits. It could also reflect the historical perspectives of community bankers going back to the 2008-2009 Great Recession in which loan participations, particularly in real estate loans, led to some significant loan losses for participants. For those banks involved in loan participations in 2023, their attitudes toward them are not surprising. More than 69% of respondents noted they primarily sell participations because of legal lending limit issues, while they primarily purchase participations to earn additional interest income. Only 2% reported they purchase participations to earn credit under the Community Reinvestment Act (CRA).

FIGURE 34

What percentage of loans sold at your bank are loan participations?

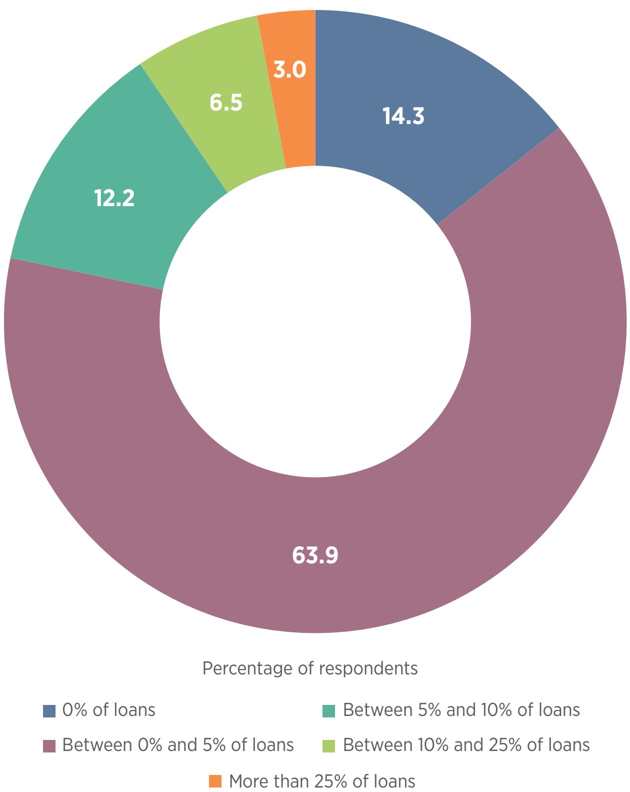


FIGURE 35

What is the primary reason loan participations are sold at your bank?

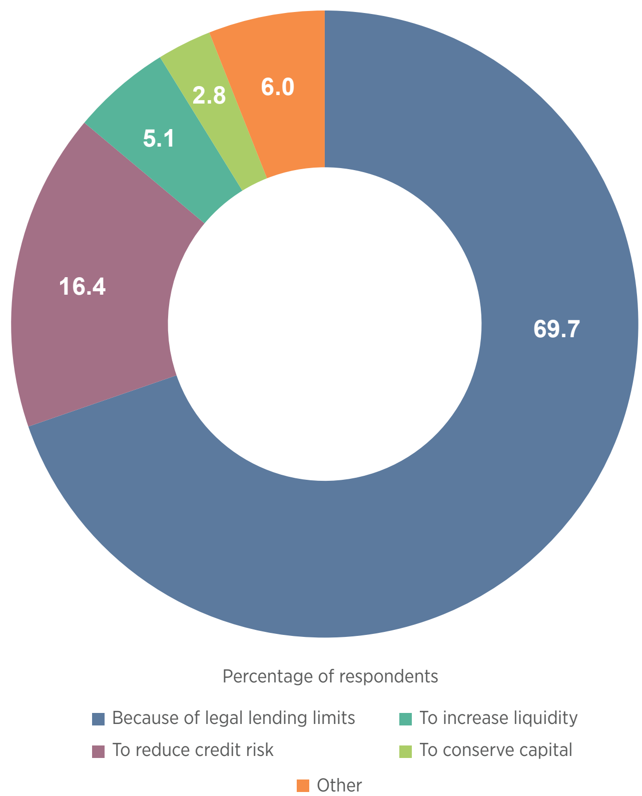


FIGURE 36

What percentage of loans purchased at your bank are loan participations?

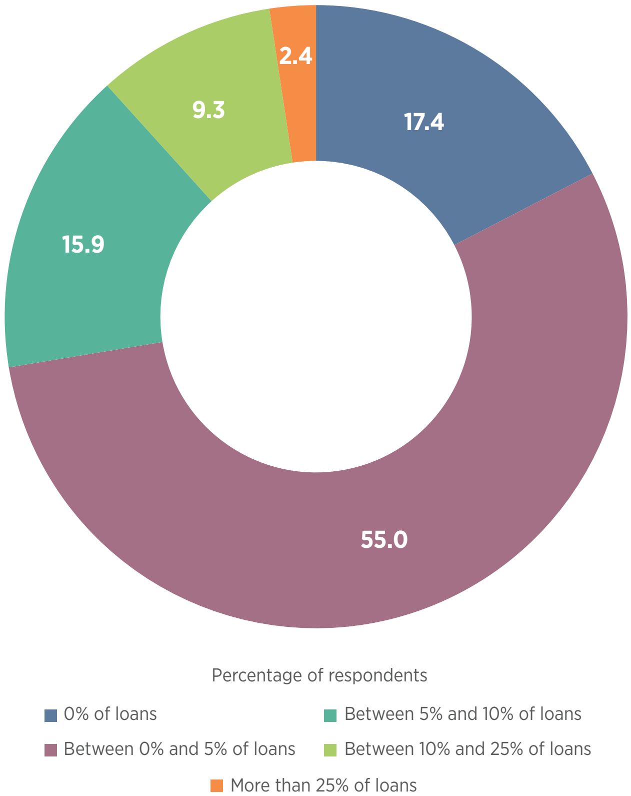
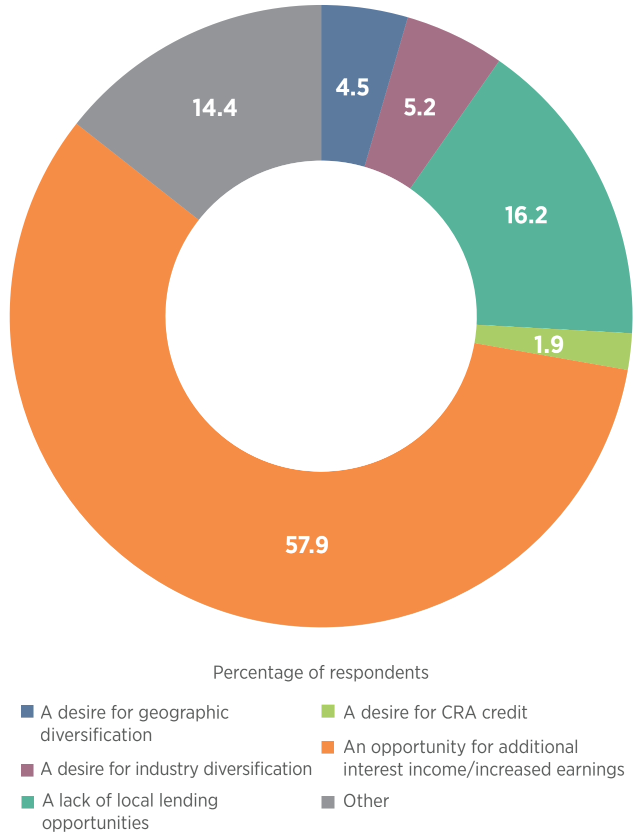


FIGURE 37

What is the primary reason loan participations are purchased at your bank?



Survey participants indicated that compliance costs, as a percentage of various overhead costs, generally continued to fall. Legal expenses saw the greatest year-over-year decline to 12% as of Dec. 31, 2022, from 27% as of Dec. 31, 2021. Accounting and auditing was another category that saw a significant decline in compliance costs in 2022 compared to 2021, after its share had been roughly around the 40% mark for the last four years. The reasons for these declines could be attributed to the efforts related to reducing regulatory burden for the smallest banks by lawmakers and regulators, which is now showing its effect in these expense categories. Meanwhile, personnel expenses was the only category that saw a slight increase in the share of compliance-related costs, rising to 12% as of Dec. 31, 2022, from 10% as of Dec. 31, 2021.

TABLE 5

Compliance costs as a percentage of total expenses by category

	Dec. 31, 2018	Dec. 31, 2019	Dec. 31, 2020	Dec. 31, 2021	Dec. 31, 2022
Personnel (salary and benefits)	**11.3**	**10.3**	**9.8**	**10.3**	**12.2**
	(6.4)	*(5.8)*	*(5.2)*	*(6.9)*	*(10.0)*
Data processing	**18.0**	**17.1**	**17.1**	**17.6**	**14.2**
	(12.6)	*(11.0)*	*(12.1)*	*(14.0)*	*(10.0)*
Legal	**22.8**	**22.6**	**22.6**	**26.8**	**12.1**
	(14.5)	*(14.3)*	*(15.4)*	*(20.2)*	*(1.0)*
Accounting and auditing	**42.4**	**42.3**	**42.8**	**39.5**	**30.9**
	(35.3)	*(36.5)*	*(37.2)*	*(33.8)*	*(25.0)*
Consulting and advisory	**40.5**	**38.2**	**41.8**	**36.1**	**22.5**
	(34.4)	*(28.2)*	*(33.3)*	*(30.7)*	*(5.0)*

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

AQUISITION ACTIVITY

Consolidation activity has slowed among both potential buyers and sellers due to uncertainty regarding interest rates and the economic and regulatory environments. According to the FDIC's annual *Merger Decisions* reports,[8] the number of regular bank mergers nationwide fell to 68 in 2022, compared with 105 in 2021 and 76 in 2020.

Prior to the COVID-19 pandemic that started in 2020, the annual number of mergers from 2013 through 2019 were 142, 144, 139, 125, 110, 141 and 125, respectively.

In the 2023 survey, only 6% of surveyed community bankers said they had received and seriously considered an acquisition offer, down from 8% in 2022 and 7% in 2021. Meanwhile, 12% reported they had made a bid to acquire or merge with another institution, up slightly from 11% last year and in 2021.

FIGURE 38

Have you received and seriously considered accepting an acquisition or merger offer in the last 12 months?

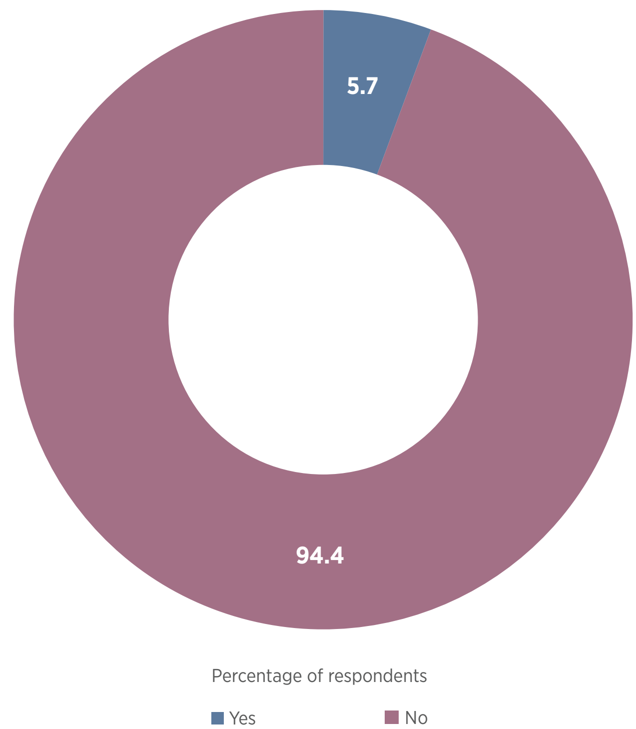


FIGURE 39

How important were the following factors in your decision to seriously consider accepting the acquisition or merger offer?

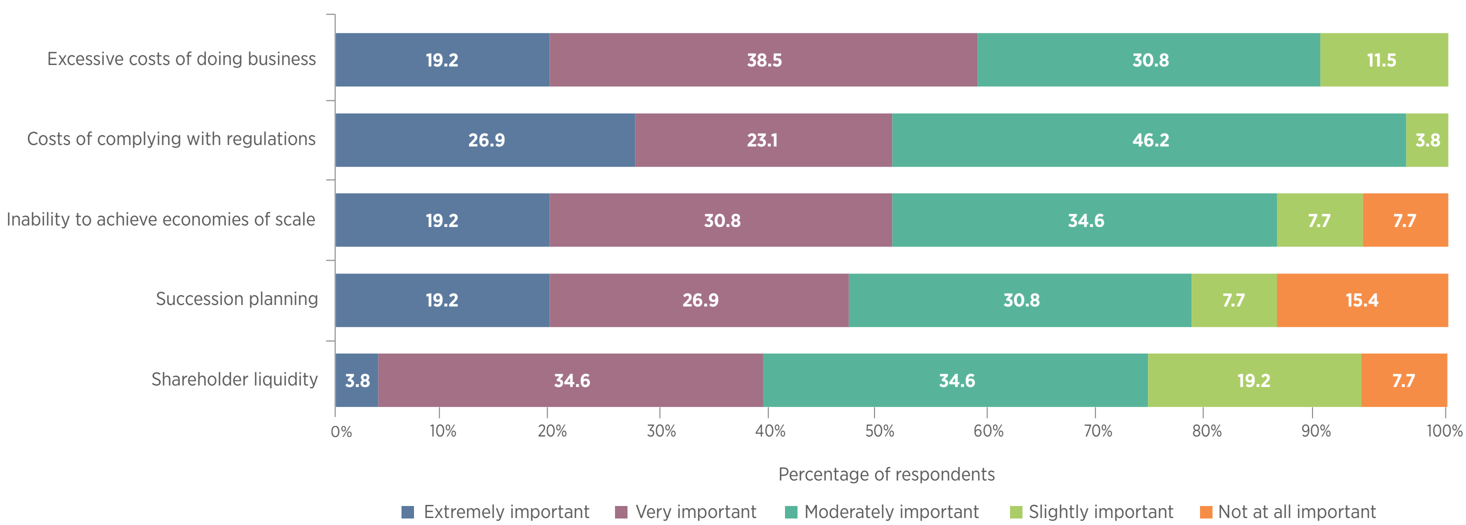


FIGURE 40

Have you made an offer to acquire or merge with a target institution in the last 12 months?

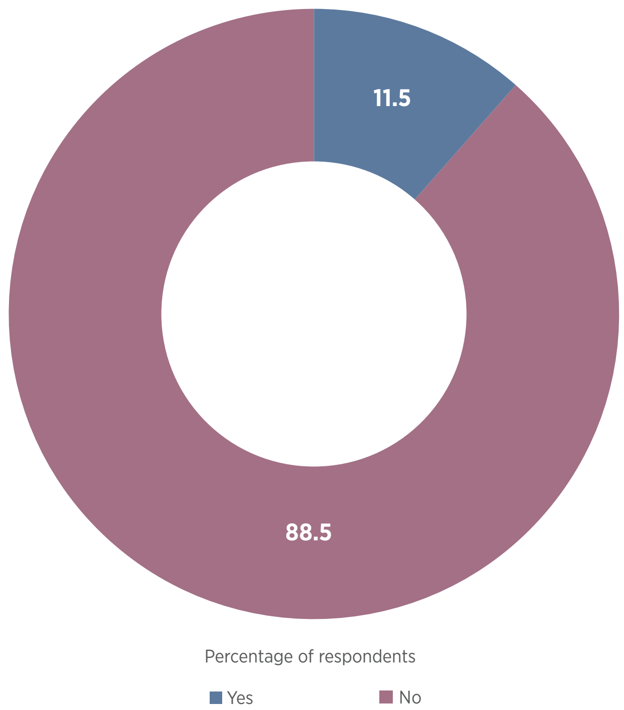
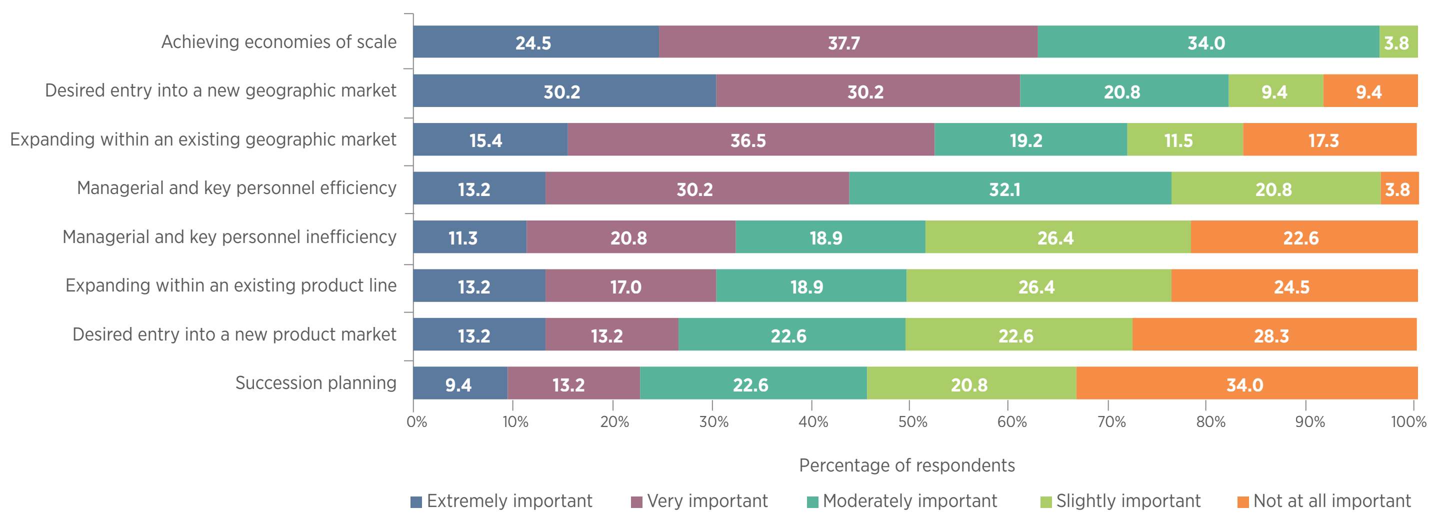


FIGURE 41

How important were the following motivations for making the offer?



The 2023 survey kicked off in April, right on the heels of the closures of tech-centric Silicon Valley Bank on March 10 and Signature Bank on March 12. First Republic Bank was shut down several weeks later on May 1. These banks had exacerbated liquidity pressures, with high concentrations of uninsured deposits that were deployed into securities and longer-duration loans, when interest rates were at historic lows. This sparked panicked depositor runs not only at these banks, but also at tech-centric and other banks, and rattled U.S. and global banking markets overall. To prevent the risk of further contagion, on March 12, 2023, the secretary of the Treasury, acting on the recommendations of the FDIC and the Federal Reserve and after consultation with the president, determined that the FDIC could use systemic risk authorities under the Federal Deposit Insurance Act to protect uninsured depositors in resolving those institutions. As a result of this designation, the Federal Reserve Board established the Bank Term Funding Program to provide additional funding to eligible depository institutions to help ensure they have the ability to meet the needs of all their depositors. The program closes March 11, 2024. As of Aug. 3, 2023, more than $105 billion had been distributed. The overall impact of the program will not be known until next year and will likely be an area of focus in the 2024 annual survey.

These failures were respectively the second-, third- and fourth-largest failures in U.S. banking history. They prompted an intense review of these and other banks' business practices, as well as the banking supervision and regulation system itself. They also prompted the inclusion of four special questions related to these events for this year's survey.

While the majority of the calls for reform have been directed at mostly the large, systemically important banks, most community bankers surveyed during the period from April through early July were "extremely concerned" or "very concerned" about an increased regulatory response. Moderate concern was also noted by several of the bankers interviewed as part of the "Five Questions for Five Bankers" supplement to this report, who also noted that some regulatory change may be appropriate. Some were already preparing to change how they handle uninsured deposits and are boosting capital levels.

When asked about their confidence in their ability to access sources of contingency funding, however, 94% of surveyed bankers replied that they were "extremely confident" or "very confident."

FIGURE 42

How confident are you in your bank's ability to access sources of contingency funding?

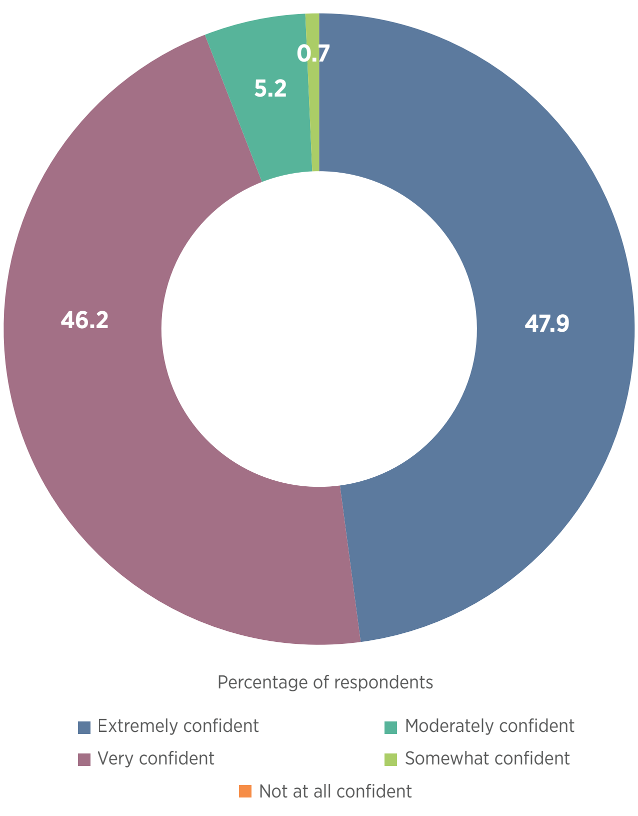
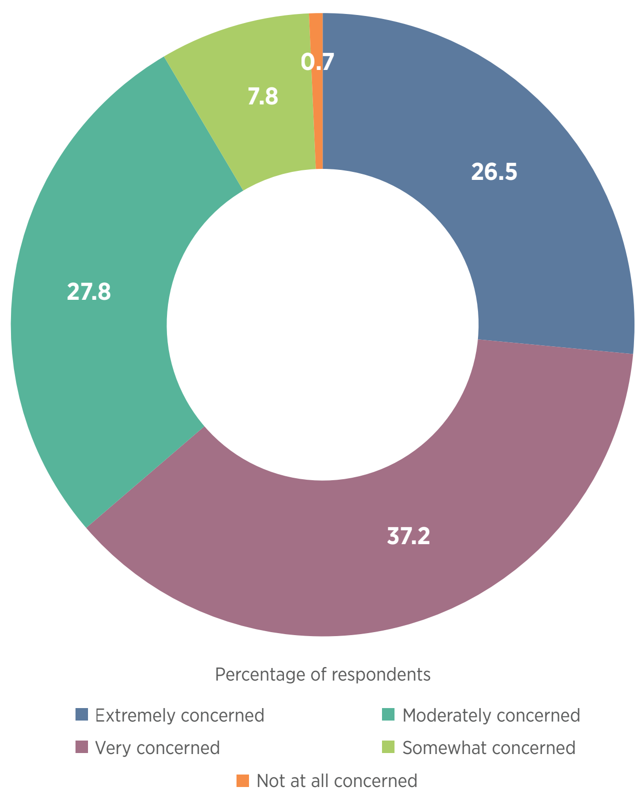


FIGURE 43

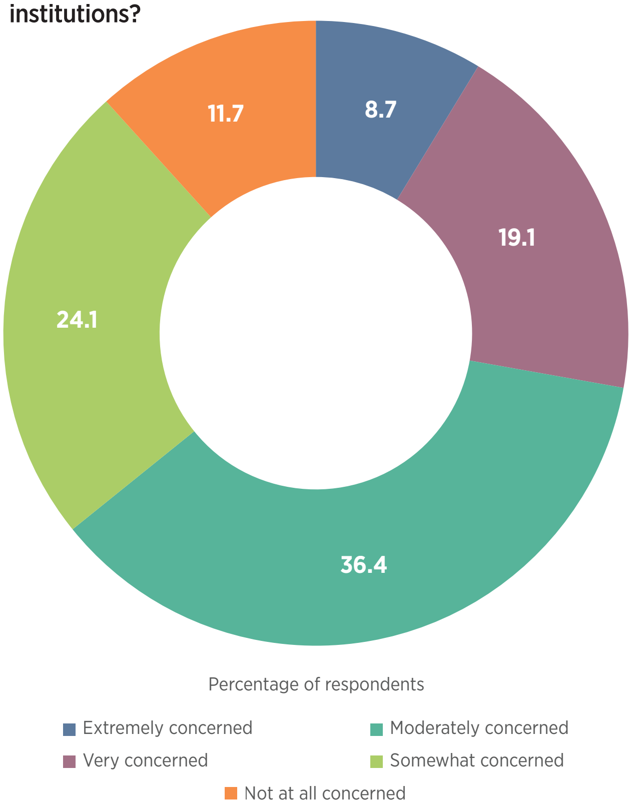
To what extent are you concerned about the regulatory response to the banking issues that arose in March 2023?



Bankers are concerned about the regulatory response to the banking issues that arose in March 2023. More than 63% reported they were either "extremely concerned" or "very concerned," while approximately 28% were "moderately concerned."

FIGURE 44

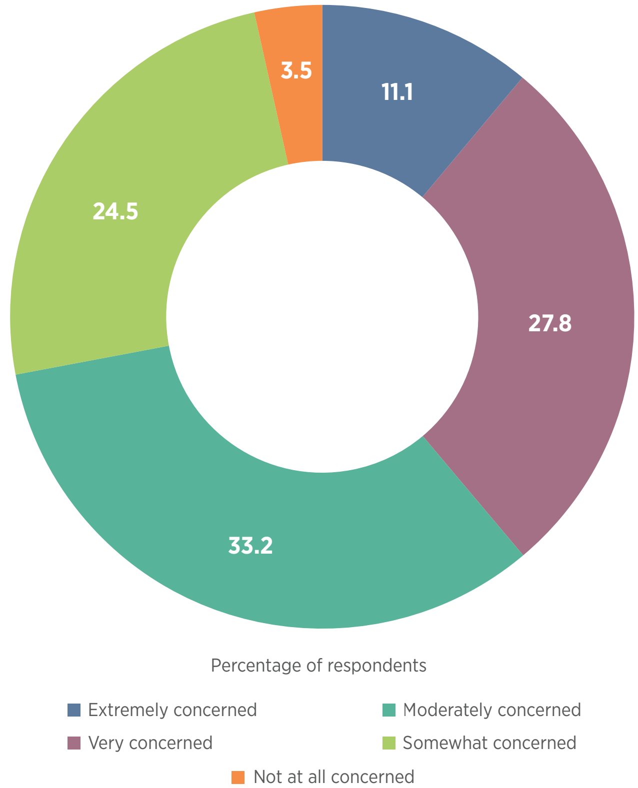
To what extent are you concerned about your bank's existing customers preferring to bank at larger institutions?



Bankers are not as concerned that their existing customers will prefer to bank at larger institutions in the wake of issues that arose in spring 2023. Only 9% stated they were "extremely concerned," with another 19% stating they were "very concerned."

FIGURE 45

Similarly, to what extent are you concerned about deposit flight?



Bankers expressed elevated concern regarding deposit flight, with 11% saying they were "extremely concerned" that existing customers would move their business to a larger institution. An additional 28% said they were "very concerned" that this would happen.

Bankers' Perspectives:

I, along with many other bankers, have studied the failures. It was extraordinary to see how much money could be moved so quickly through digital channels in March. Given that we're just a classic community bank, we don't have a client base that would ask for the ability to transfer huge tranches of money via an app or one of our digital products.

We received a preview of things to come from the July 10 speech from Fed vice chair for Supervision, Michael Barr. From what I'm reading and understanding, it appears the regulatory/supervisory response will primarily impact those institutions at the $100 billion total asset size and above in the form of increased capital. We're about 100 times smaller than that at only $1 billion. I believe that our current capital levels are appropriate as outlined now. However, I certainly don't expect any of our safety and soundness exams to be any less rigorous. In addition, I think more monitoring of uninsured deposits will apply to all of us.

If increased capital levels are overdone, I'm concerned that it will impede the basic functions of community banks and all banks.

—Dylan Clarkson, Pioneer Bank & Trust
Belle Fourche, South Dakota

I think there will be more scrutiny. We will likely see a bit of an overreaction. There's going to be a greater emphasis on interest-rate risk with the increasing cost of funds, unrealized losses on securities and uninsured deposits. I hope that community banks are not severely impacted by the overreaction of the regulators.

From a positive standpoint, it will force customers to evaluate their funding plans. In all likelihood, it will force institutions to add additional sources of funding. I believe this will be a positive development. In addition, it will make institutions take a step back and look at their interest-rate risk policies and practices, as well as their makeup and reliance on uninsured deposits. These are all good things. Regarding any potential harmful effects, I can see a scenario in which all banks will be required to carry more capital on their balance sheets. While this response is intended for the larger institutions, I am concerned that it will filter down to all institutions. Also, if unrealized losses on securities are included in the capital calculation, this could certainly be harmful.

Not all banks are the same, and small community banks do not have the risk profiles that led to the failures. We certainly hope that the regulators will exempt community banks with low-risk profiles from additional regulation.

—Brent Vidrine, Bank of Sunset and Trust Co.
Sunset, Louisiana

I expect that there's going to be a much greater attention to detail with regard to interest-rate risk management. It's already an area that is heavily monitored and watched. But when you look at the circumstances surrounding the failure of Silicon Valley Bank in particular, in my opinion, there were things that were being done that were not in conformance with safe and sound banking practices, as they pertain to interest-rate risk management. I think we're going to see a lot of attention on that, which needs to happen because it's important.

So I'm sure there will be more regulation. I think that seems to be the regulators' answer to everything—more regulation. But this is a double-edged sword. It's necessary, but it can be awfully onerous to us small banks, particularly when we are not engaging in some of the risky behaviors that spawn these new regulations. They burden us. It's a challenge. I think we need a greater focus by the regulators on rightsizing the regulations in accordance with the size and scope of the institutions.

It's not one size fits all. From the operational standpoint of what we're doing compared to what Silicon Valley Bank or Signature Bank were doing, we're nothing like that. So I hope that when they come up with whatever comes out of this, that they take a look at who their subjects are before just dumping more regulations on us.

While I believe regulation is necessary, it's also extremely burdensome, particularly things like BSA/AML and a variety of other things. With regard to safety and soundness, common sense would say that a bank manager or a CEO would do everything he/she could to operate his/her bank in a safe and sound manner—never compromising safety and soundness for profitability. But it's evident to me that without those regulations and without the watchful eye of the regulators, we would probably see more train wrecks. So I'm glad the regulators were there. I'm glad that we have regulation. I just hope that when the new regulations come out, they consider who their audience is and that they regulate the people that need the regulation and not everybody "just because."

—Andrew West, Eagle Bank
Polson, Montana

CONCLUSION

As we acknowledge the 10th year of the CSBS Annual Survey of Community Banks, it's helpful to reflect on how community banks have viewed the evolution of the opportunities and challenges facing their industry over this period.

In the first few years of the survey, bankers were still adjusting to the significant supervisory and regulatory responses to the 2008 financial crisis and subsequent recession. Concerns tended to focus on compliance costs and regulatory burden, as a litany of new rules and regulations were implemented following the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Community bankers seriously questioned their ability to actively participate in the residential real estate and commercial real estate lending markets and expressed concern over what they viewed as significant threats to their business model and their ability to compete with the larger "too big to fail" banks.

One of the most important contributions of this survey at that time was to quantify the cost of compliance across the five dimensions of a bank's noninterest expense categories. The data enabled researchers and policymakers to start quantifying the extent of compliance burden facing banks and highlighted how that burden had a disproportionate impact on the smallest community banks.

The compliance question has transcended all 10 years of the survey, and while compliance costs remain a concern of community banks, the responses to the question also quantified the resilience of community banks. We can see how quickly banks adjusted to regulatory changes, internalized the associated costs and worked toward stronger profitability.

From compliance costs and regulatory burden, banker concerns then shifted to competition—particularly competition from nonbanks—as financial technology firms proliferated in the mid- to late 2010s. Community bankers reported feeling acute competitive pressures from these new technology firms, while also exploring strategic partnerships that enabled them to compete on a more even footing with more-technology-forward entities. At the same time, community banks experienced increased competitive pressures from larger banks and credit unions, particularly for small-business loans, which, up to that point, had largely served as a community bank book of business.

These competitive pressures also triggered liquidity pressures, because technology helped many institutions lower their overhead costs and project their brands nationally. Bankers began reporting a more national market for deposits, as their local customers began exploring deposit and, in some cases, lending relationships with institutions outside their core market areas—or with banking institutions that existed solely online. This survey provided evidence of how quickly banks adopted new technologies and how they viewed future technology acquisition and implementation.

These investments in technology paid off for many banks when the global pandemic reached U.S. shores in March 2020. Banks that made the right investments in technology were quickly able to adjust to meet their customers' needs, as businesses across the U.S. closed their doors and a significant percentage of the U.S. labor force began working remotely. Policymakers recognized the importance of banks, and specifically community banks, in allocating credit and getting funds into the hands of businesses and consumers. The Small Business Administration's Paycheck Protection Program channeled funds through the nation's banking system to small businesses across the nation.

The pandemic reportedly accelerated technology acquisition and adoption for banks that were lagging in this area. The pandemic also motivated the development of newer technologies and technology upgrades designed to enhance the user experience between banks and their customers.

Unfortunately, increasing technological reliance also increases exposures to cybersecurity and fraud risks. In the early 2020s, banks began consistently reporting cybersecurity as their top external risk—a situation that persists with the 2023 survey.

Today, community banks face new challenges in the face of high inflation, net interest margin compression and increasing costs. They also reported a renewed focus on core deposit growth and liquidity. They reported a strong and consistent focus on technology and see significant opportunities to implement technologies that enable them to compete with all competitors—banks and nonbanks alike. They still report feeling limited, somewhat, by the speed and service offerings of their core service providers but don't necessarily see a fintech solution to these issues.

While community bank sentiment throughout this year's survey period was at a low point, as evidenced by the Community Bank Sentiment Index, bankers have also shown resilience in the face of the myriad challenges they've faced. To wit: Inflation is at a more than 20-year high, but three-quarters of all respondents viewed the risks of inflation as "manageable."

This survey provides evidence for the known challenges facing community banks and offers a window into the future threats yet to materialize. It remains one of the most comprehensive assessments of the community banking industry; more than one-tenth of the industry responded to this year's questions. The survey also provides data that cannot be obtained elsewhere to support future research and analysis on community banking. Among the many contributions of the CSBS Annual Survey of Community Banks, its ability to provide unique data insights to researchers is perhaps its most significant.

ACKNOWLEDGMENTS

The 2023 CSBS Annual Survey of Community Banks was administered by state bank commissioners in 32 states. A total of 462 community bankers participated. To request a print copy of this publication, email the conference committee at info@communitybanking.org. Participation in the 2023 survey would not have been possible without the efforts of the following state bank commissioners and their staffs.

Alabama

Mike Hill, Superintendent of Banks
Alabama State Banking Department

Arkansas

Susannah Marshall, Bank Commissioner
Arkansas State Bank Department

California

Clothilde "Cloey" Hewlett, Commissioner
California Department of Financial Protection & Innovation

Colorado

Ken Boldt, State Bank Commissioner
Colorado Division of Banking

Connecticut

Jorge Perez, Banking Commissioner
Connecticut Department of Banking

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Virginia Bureau of Financial Institutions

Washington

Charles E. Clark, Director
Washington State Department of Financial Institutions

Wisconsin

Cheryll Olson-Collins, Secretary
Wisconsin Department of Financial Institutions

ENDNOTES

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2023
Five Questions for Five Bankers

1. **Many labor market surveys continue to indicate the challenge of attracting and retaining talent. In this environment, how does your institution recruit and retain the next generation of bankers?**
2. **What has been the impact of the rapid interest rate rise on your institution, and what lessons have you taken away from this experience?**
3. **What is your outlook with respect to funding and liquidity for your institution over the next three years? What changes do you foresee in your ability to raise and retain core deposits?**
4. **How are you thinking about the competition for deposits and loans in today's interconnected and digital economy?**
5. **What legislative, regulatory and/or supervisory responses do you expect to surface in response to the March bank closures? What potential responses do you see as constructive or harmful to your institution and to the community banking industry?**

Dylan Clarkson

President and CEO, Pioneer Bank & Trust
Belle Fourche, South Dakota

Dylan Clarkson is the president and CEO of Pioneer Bank & Trust in Belle Fourche, South Dakota. He is a fourth-generation banker with Pioneer, which was founded by his family in 1913. A native of Belle Fourche, Clarkson graduated with his bachelor's degree in economics from Montana State University, Bozeman, Montana, in 1997. He spent 19 years outside of the "family business," working in the automotive industry and then as vice president and Bozeman market manager for American Bank in Bozeman. Prior to joining Pioneer in 2016, he began serving on its board of directors in 2014. Clarkson currently serves as the chair of the Federal Reserve Bank of Minneapolis' Community Depository Institutions Advisory Council (CDIAC) and is a member of the national CDIAC. He also serves on the CSBS Bankers Advisory Board and is a board member of the South Dakota Bankers Association.

Many labor market surveys continue to indicate the challenge of attracting and retaining talent. In this environment, how does your institution recruit and retain the next generation of bankers?

One of our largest responsibilities is managing our human capital, so we are constantly reviewing, innovating and surveying the market and our benefits package. I believe that we have some unique benefits, one of them being our child care assistance program, which is essentially a credit or a direct payment to child care providers in the different communities in which we operate. It's not necessarily addressing the shortage of providers, but it is helping with that expense. It's been very well-received and helps retain a certain demographic of our employees. We have a very generous paid-time-off model and some unique but small perks, such as a birthday off and a two-day employee retreat, and a profit-sharing contribution that does not require a match. (We're constantly monitoring our benefits package and, we believe, are staying relevant.) Much of our recruiting efforts are word-of-mouth. The word is out, for example, on our child care assistance program; in addition, our community involvement, as our employees are out in the community supporting a particular event or function, also helps us attract talent. We operate in small communities, and we often have folks approaching us for positions. It certainly helps us recruit just by being present in the communities.

What has been the impact of the rapid interest rate rise on your institution, and what lessons have you taken away from this experience?

A key lesson learned: Stay disciplined. With interest rates rising 500 basis points over approximately 18 months, that was a wild ride, especially in midsummer and early fall last year, as we were looking at jumbo rate hikes at each Federal Open Market Committee meeting. The forward guidance that was issued was just that. It was an indication, no guarantee, and the interest rate environment certainly changed faster than any banker anticipated.

We've certainly adjusted some of our deposit rates upward, but we're not necessarily striving to be the highest deposit-rate payer nor the low-cost provider on the other side of the balance sheet for credit. We didn't have a huge amount of core deposit runoff. We had some unique circumstances that led to some deposit runoff, but really nothing to do with interest rates; just businesses transitioning and selling. But again, certainly the key for us was trying to be as short as we could in our portfolio while struggling to get yield as well.

I guess as far as lessons we're learning, I think some of those lessons might be learned in future years. We're just trying to stay very disciplined and short in the duration on our deposit products. This is yet another cycle. It will change again, and we don't want to be extended on our deposits.

What is your outlook with respect to funding and liquidity for your institution over the next three years? What changes do you foresee in your ability to raise and retain core deposits?

Liquidity is, of course, a concern for all of us. As best we can, we must make sure that we've got ample sources of liquidity and a stable core deposit base.

We've been hesitant to have any kind of a marketing campaign that focuses on attracting what I call "hot" money. We don't want to attract more unstable funding. We really are a consumer and small-business bank—a Main Street bank. So having stable operating business transaction accounts and checking accounts is really where our focus is. It's having good core deposits. We are a small-business bank, and that just lends well with our model, and it's an appropriate product.

We're not necessarily the highest yield payers, but if we do have customers who have been with us that are looking at moving their funds, whether it's to a brokerage or an online provider offering a higher rate, we will work hard to keep that deposit. For example, on a situational basis, we will raise a CD rate for a long-time customer if he or she is looking at moving those funds elsewhere. However, the time and money that we invest in our communities are also very unique and prescient to retaining our customers. When we're negotiating a rate on a CD, it's not unusual for a customer to factor in something like the bank's support for a local foundation for public education. It matters to them. While we might not be quite there on rate, they are still going to stick with us because they know their money is working in their community.

How are you thinking about the competition for deposits and loans in today's interconnected and digital economy?

As I mentioned earlier, we have internal soft specials, more oriented to retaining our existing customer base than to attracting new, but not necessarily loyal, customers. Our focus is on our existing client base and taking care of them. Not that we won't take new deposits; of course we do.

For our traditional branch-oriented services, we have a suite of digital products including online loan applications for consumers and online deposit account opening. We also have some online digital products that allow for external transfers. They have very low limits. We're working very hard to be comprehensive for our size of an institution, not only through our employees staffing our retail facilities, but also through our digital offerings. We remain focused on giving our customers more reasons not to leave.

What legislative, regulatory and/or supervisory responses do you expect to surface in response to the March bank closures? What potential responses do you see as constructive or harmful to your institution and to the community banking industry?

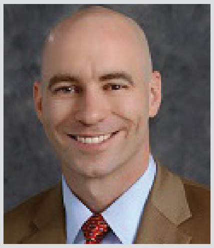
I, along with many other bankers, have studied the failures. It was extraordinary to see how much money could be moved so quickly through digital channels in March. Given that we're just a classic community bank, we don't have a client base that would ask for the ability to transfer huge tranches of money via an app or one of our digital products.

We received a preview of things to come from the July 10 speech from Fed vice chair for Supervision, Michael Barr. From what I'm reading and understanding, it appears the regulatory/supervisory response will primarily impact those institutions at the $100 billion total asset size and above in the form of increased capital. We're about 100 times smaller than that at only $1 billion. I believe that our current capital levels are appropriate as outlined now. However, I certainly don't expect any of our safety and soundness exams to be any less rigorous. In addition, I think more monitoring of uninsured deposits will apply to all of us.

If increased capital levels are overdone, I'm concerned that it will impede the basic functions of community banks and all banks.

Greg Hayes

President and CEO, Kish Bank
State College, Pennsylvania



Greg Hayes is the president and CEO of Kish Bank in State College, Pennsylvania. Over his career, Hayes has served in various roles of increasing responsibility at Kish, including teller, management trainee, branch manager and retail lender, commercial lender, vice president of Lending Services, senior vice president of Client Solutions, and executive vice president and head of Retail Banking and Client Solutions. Most recently, he served as senior executive vice president and chief operating officer. Hayes is a graduate of Lafayette College, Easton, Pennsylvania, where he earned his Bachelor of Science in mechanical engineering. He also graduated with honors from the Pennsylvania Bankers Association's School of Commercial Lending and its Advanced School of Banking, where he currently serves as a director. Prior to joining Kish, Hayes was a mechanical services engineer and a supervisor with Merck & Co. Hayes is the past chair of the board of the Bob Perks Fund, which financially supports individuals and families battling cancer in six Pennsylvania counties. In 2011, he received the Centre County Community Foundation's "Future of the Foundation Award" for his extraordinary commitment to the community, including leadership roles with Habitat for Humanity, the YMCA and the Palmer Museum of Art at Pennsylvania State University. He is currently a member of the CSBS Bankers Advisory Board.

Many labor market surveys continue to indicate the challenge of attracting and retaining talent. In this environment, how does your institution recruit and retain the next generation of bankers?

Obviously, retention and turnover have been an increased focus in the current employment market. With everything that has been going on, we've been really impressed and excited about the talent that we have been able to bring into our organization.

There are a few things that we are doing from a recruiting perspective: We have found that many bankers are looking for a high-performing community bank where they are able to support their clients and help their clients achieve their goals without overly burdensome processes and policies that restrict their ability to be a good banker and a good risk manager. When they can find it in a growing organization with a strong relationship-based culture, they are eager to join. In addition to attracting talented bankers, we're also working at bringing new talent into the industry and new talent into our organization. We have experienced a higher level of retention issues, specifically a higher level of new people coming into the organization and then leaving in the first six months to a year. We are trying to understand what is causing this and elevate our focus on the upfront hiring and recruiting by providing a lot more clarity of the role that people are stepping into, the responsibilities they will have and the progression of that role. We are also elevating our training and development to ensure that those who are new to banking really feel prepared for the role; that they get gratification of performance and growth, as well as seeing progression in their responsibilities. While it's important that we are focused on development, it's also important that we are exciting them with career paths.

In the traditional banking career path model, you could go into management, or you could go into more technical expertise. We are trying to focus on building the career path and the relationship side of banking, where people can grow their responsibilities from a retail banker—traditional transaction-line account opening—up through concierge banker, where they have a breadth of knowledge and experience across multiple products and business lines. Perhaps they can become a retail lender, or they can manage relationships through other business lines, insurance, wealth management, or different aspects of mortgage lending, business banking, etc. Kish Bank is focused on expanding that career path by increasing our training across the board and investing in them. We are trying to measure engagement so that we can identify where we have issues, or pockets, to ensure that we're addressing team member concerns.

We are listening more and focusing on core elements of our culture by providing clarity, strong communication and strong leadership. This requires that we elevate our focus on educating and developing our managers. It has been an interesting time as the job market has produced an evolution of how we bring people into the organization and how we develop and retain them.

What has been the impact of the rapid interest rate rise on your institution, and what lessons have you taken away from this experience?

We have been doing very well in the rising-rate environment, outperforming previous years, as our organization was well-positioned to manage the rising-interest-rate environment. On the asset side of the balance sheet, we have had strong growth in variable-rate loans, which is due to a strategy we put in place back in 2019 to diversify and grow our loan portfolio. With that strategy, along with a robust Paycheck Protection Program effort, we were able to lend out the excess liquidity that was flooded into the market by the government during the pandemic. This strategy meant that we didn't have to purchase a lot of securities when rates were really low. Variable-rate loans, in this rising-rate environment, have been beneficial to us. We have very few held-to-maturity securities. Most of our portfolio, which is small, is held for sale. We also have a very sophisticated hedging program, which has helped us manage interest-rate risk. Managing volatility and interest rates has been an intense focus for us.

What is your outlook with respect to funding and liquidity for your institution over the next three years? What changes do you foresee in your ability to raise and retain core deposits?

We manage our liquidity through many different sources. It is important to us that we have access to liquidity when we need it, and that means that we have to manage our sources of liquidity, but our primary focus is growth and deposits.

Strong growth in variable-rate loans has allowed us to be competitive with deposit rates, while maintaining margin, even as liquidity in the banking system is drying up. We have been able to attract new deposits from other organizations that have not had similar loan demand.

We are also currently moving into two new markets that represent a significant opportunity for growth and core business deposits, which is our primary focus. We are looking for more opportunities as we go forward, including additional markets to grow into. We are an organization that has never done an acquisition. We've always grown organically. We do that by attracting talent in new markets, lifting out a team and bringing them on board to help us grow.

As we have had relationship managers join us, they are bringing their business clients. That means we must have strong treasury management and cash management products to support the business relationships. We are focused on that. And as we have recruited strong talents in the area of business banking, we're also developing talent.

The small- to mid-size business segment demands really strong support from a trusted local banking relationship. Many of the organizations that we compete against are losing sight of taking care of both their employees and their clients.

So, we are wholly focused on our clients by taking care of our employees and by acquiring great talent. We believe our ability to deliver the best products and services to our business banking clients will help us continue to grow low-cost core deposits or relationship deposits. That said, it is not just the business side. On the retail side, we're also focused on relationship banking. We understand that transactions are digital and many clients demand that self-service digital experience, which we provide through great technology. But when it comes to having a question or wanting support, we know they just want a human to interact with; someone that they know and trust. So, we have built that human interaction into our digital experience. We are also focused on adding physical locations to many of our communities. The access to a live, local, in-person banker is what people are looking for, and we've opened two new locations in the last six months. We have two more planned in the next year, and it is a significant element of attracting deposits as we grow. We are doing this in a low-cost way. It's not the traditional model with significant overhead, and it's been an important strategy for us in support of the loan growth strategies.

How are you thinking about the competition for deposits and loans in today's interconnected and digital economy?

We no longer compete with the traditional banking brand. We compete with the technology brands that have banks standing behind them, and this adds a tremendous level of competition for the experience we provide—specifically, the experience we provide through technology. It's important that as we utilize that technology, we continue to expand the products and services to be competitive. We also understand that the ability to move money is getting faster and easier. With new technology, the speed of money movement in the financial system is getting more complicated for the average banking client. The threat of fraudsters trying to get access to their money is increasing every day. We understand that most people are looking for help in understanding what is going on, such as the new products and services that are available, whether something is safe or not, whether or not they should attach their debit card to their digital wallet and their phone. They just want the reassurance and confidence from someone they know and trust, and we want to be that local banker.

We're focusing on building relationships and supporting people's needs. We've seen product evolution before. And we've been able to stay focused on what is important: the client. Take mortgage lending, for example. It used to be that when customers needed a mortgage, they'd go to a local community bank, and that bank would do the mortgage and hold it on its balance sheet. As the secondary market for mortgages grew and evolved, community banks realized that people still wanted to work with a local banker, they just didn't care as much where that mortgage was held. So, we are still that bank. It's just that the mortgage isn't on our balance sheet anymore, and that's an evolution of the industry.

The evolution of banking products will continue. Who knows, maybe someday deposit products will be the technology front end, and balances will be held differently in the future. The fact is, customers are still going to want someone that they know and trust in their local community to be able to talk to, and that is where our focus is, on building those relationships and ensuring that we are the people they come talk to when they have a need. Over the past 15 years, there has been a lot of talk about how millennials are going to flip the script on banking and kind of revolutionize everything. As it turns out, having a trusted advisor to talk to during a major life event is just as important to millennials as it is to Gen Xers and baby boomers. The demand for a higher level of technology interfaces is absolutely there. We are invested in it, and we're bringing it to the table, but the true differentiator really comes down to the human relationship that's there when they have questions, independent of generation.

What legislative, regulatory and/or supervisory responses do you expect to surface in response to the March bank closures? What potential responses do you see as constructive or harmful to your institution and to the community banking industry?

I believe the March bank closures were a very specific failure of management and supervisory oversight. I do anticipate significant legislative and regulatory reaction to the bank failures because history has shown us that the pendulum swings wide, especially when there are failures in the banking system, no matter how specific it was to the banks involved and how they were managing their balance sheets and interest-rate risks. Even though those specific banks were niche, what comes out of this will affect all banks, and so we have concerns.

We anticipate new regulations around internal liquidity stress testing and overall stress testing. We think there will be requirements for things like reporting the percentage of uninsured deposits, and we welcome that. We have less than 25% of uninsured deposits; the banks that failed had greater than 80%. There are going to be new mark-to-market rules from an accounting standpoint, especially on held-to-maturity securities. We do worry about the burden of increased regulation and a higher level of accounting treatments. We think the treatment of accumulated other comprehensive income (AOCI) and its impact on regulatory capital levels are going to be looked at and inspected differently. When we mark-to-market our securities, it flows through that AOCI. While that doesn't have an impact on regulatory capital, it does show up in our balance sheet as an impact on capital and tangible equity.

We also think there will be other expectations, like increased capital levels, which increase the costs of doing business. They increase the difficulty of producing return for shareholders when you're holding higher levels of capital. It's not as efficient.

The strength of the U.S. banking system is based on capital, and we understand that. There also needs to be better control around the kind of predatory stock short selling of publicly traded banks, which really amplifies the issues affecting the soundness of the banking system. When the 2008 banking crisis happened, they stopped the short selling of banks; they did not do that this time, and I think it really had a significant impact on the failures of the banks, because it's the capital that stands behind the industry. If publicly traded banks can be short sold in times of distress, it can have a significant impact.

On the examination side, I do believe that the staffing and the training of examiners is a huge issue. It needs to be addressed, unfortunately. We are all pulling from the same talent pool—people who have banking industry experience. It's going to drive up the cost of examinations. It's going to drive up the cost of providing banking services. It's definitely something that's going to need to be addressed. If examiners don't know the difference between [a Silicon Valley Bank] and a community bank like Kish, and they come in with the wrong approach, they're going to have a negative impact on one side, and they're going to miss things on the other side. We believe that on-site, in-person examinations will be critical. You can get a lot from reading financial statements, but talking through issues in person with the leadership team and understanding how a bank runs its business are such a critical part of the examination process.

The final comment I would make in regard to regulation and examination involves the need to look at the evolving state of a digital economy and a digital banking system. The Fed and the FDIC are going to have to consider how they monitor and support the outflows of funds from banks, especially considering real-time payments and FedNow. The ability to move money changes what is a very outdated procedure for protecting against a run on a bank. The Fed and the FDIC need to look at that and understand how their model needs to shift to protect the banking system when there are times of distress like we experienced in March 2023.

Orv Kimbrough

Chairman and CEO, Midwest BankCentre
St. Louis, Missouri

Orvin "Orv" Kimbrough serves as the chairman and CEO of Midwest BankCentre, the second-largest privately owned local bank in St. Louis, with more than $2 billion in assets and $1.5 billion in loans. Prior to joining Midwest BankCentre, Kimbrough spent nearly 20 years in leadership roles in prominent nonprofit agencies, most recently as the president and CEO of the United Way of Greater St. Louis. During his tenure, this United Way chapter grew to the nation's largest affiliate, raising nearly $80 million annually. Kimbrough started with United Way in 2007 as vice president of Major Gifts. Kimbrough earned his bachelor's and master's degrees in social work from the University of Missouri-Columbia and his MBA from the University of Missouri-St. Louis. He also holds a master's degree in theology from the Aquinas Institute of Theology. He serves as a member of the Federal Reserve Bank of St. Louis' Community Depository Institutions Advisory Council and on the board of the St. Louis Regional Economic Development Alliance.

Many labor market surveys continue to indicate the challenge of attracting and retaining talent. In this environment, how does your institution recruit and retain the next generation of bankers?

Reputation and Recruitment: The hiring process starts long before we see an application. The next generation of bankers is looking for companies that are interested in more than making money; they want to know they're making a difference in the world and that their work has purpose. Midwest BankCentre (MBC) has done tremendous work to communicate and share our purpose through both words and actions, with a concerted social media strategy that includes a partnership between human resources (HR) and marketing. This partnership enables consistent and cohesive messaging between the two areas that allows HR to leverage the work of the marketing group in recruitment. We have been told consistently that our orientation toward purpose is why new recruits are interested in MBC. They have seen us online, like what we stand for and want to try us out. This is a differentiator. We also leverage multiple points for connection and interaction with potential employees through:

- Networking and partnerships with educational institutions, professional organizations, etc.
- College campus recruiting events and presence at their events to connect with young talent
- A newly launched intern program
- Video-based postings and recruitment efforts to panoramically show who we are
- Streamlined and common processes around the interviewing and hiring process

Focus on Development: When we recruit and onboard, we are looking for career-minded individuals who are joining for more than just a job. Once employees join the organization, we are focused on introducing them into our culture and making them feel a part of the team, regardless of location or function. We offer a genuine plan for further development within the organization through Rising Together University and our one-year onboarding program. Once that is completed, employees have opportunities to engage in two mentoring programs open to everyone. They receive tuition reimbursement, formal performance and goal setting with their manager, conferences and support for certifications. New hires share with us that many companies "say" they offer internal opportunities, but they feel the authenticity from us at the very beginning because we're constantly reminding them of further development opportunities.

Focus on Diversity: The Diversity, Inclusion, Culture and Engagement (DICE) Committee is a game changer for MBC. One hundred percent of the executive team and more than 20% of our bank-wide team are active in leadership with one or more committees from DICE. This group connects our people in so many unique ways—in person, through learning and remote events, even online trivia contests—with one focus: cultivation of culture. For our DICE participants, they also have additional access to bank leadership and have opportunities to spearhead projects and teams that impact the bank. More than 70% of employees participate in at least one activity, which helps to drive employee engagement, as shown by our most recent engagement scores of 81%. Our DICE Committee helps to create a culture in which people can show up as their authentic selves to help the bank succeed. As the bank succeeds, each employee has a line of sight into how this success benefits them. This atmosphere fosters positivity, creativity, engagement, growth and incredible business results.

What has been the impact of the rapid interest rate rise on your institution, and what lessons have you taken away from this experience?

Net Interest Margin: Over the last several years, MBC has worked hard to reposition our balance sheet by reducing the dollar amount and volume of long-term, fixed-rate mortgages and layering in variable-rate commercial and industrial assets to accompany a robust position in commercial real estate lending. As a result, MBC has a diversified portfolio and an asset-sensitive balance sheet position. Consistent with our strategy, the bank has reaped some benefit from the rising-rate environment, with interest-earning assets repricing more quickly than interest-bearing liabilities. Our aim throughout the current rate cycle has been to slow-walk rate increases on interest-bearing deposits and make pricing exceptions for customers who have deep relationships, as evidenced by their use of multiple products, as opposed to repricing the entire non-maturing deposit portfolio. Given that rates are likely to be higher for a longer period, we anticipate margin compression as deposit rates catch up to the increase in loan rates. Lessons learned from this experience include the validation of our strategy of asset diversification demonstrated by the 32-basis-point increase in our margin from the beginning of the rate cycle. Another key lesson: Regardless of the environment, there should always be a focus on generating low-cost deposits.

Unrealized Investment Losses and AOCI Impact: The prolonged low-interest-rate environment, followed by 500 basis points of rate increases in just over 12 months, has impacted the valuation of the investment portfolio and tangible equity across the industry. MBC enjoyed the offsetting benefit of gains on its cash flow swaps, serving as a natural hedge to accumulated other comprehensive income (AOCI) and tangible equity. Unlike some financial institutions, MBC did not extend the duration of the investment portfolio with low-yielding investment securities, although there was a focus on taxable municipal and corporate bonds to supplement yield. Lessons learned from this experience are that rapid changes in interest rates can cause significant swings in market valuations and have unintended impacts on the liquidity stack.

Credit Risk Appetite/Credit Quality: MBC has long-standing loan portfolio practices and a balanced credit-risk appetite that has served the company well through good times and through tough economic cycles. Best-credit practices in underwriting include verifying liquidity, requiring more cash equity into projects, understanding the borrowers' management and experience, and stress-testing loan opportunities to ensure cash flow coverage can handle higher interest rates and/or declining income. Identifying problems early, staying in close contact with clients, updating financial information and monitoring past dues weekly are the pillars of timely loan portfolio management. Reviewing financial trends with customers, knowing and identifying areas of increased risk and monitoring industry concentrations help us identify issues early so measures can be taken to mitigate risk. Lessons learned from this experience are that consistently doing the hard work and the right thing when underwriting a deal, both in good times and in bad times, supports sound credit quality. There is no environment that allows for shortcuts; stay disciplined.

What is your outlook with respect to funding and liquidity for your institution over the next three years? What changes do you foresee in your ability to raise and retain core deposits?

Most community banks depend on deposits and loans for their business. Not only are we seeing alternative places to secure loans proliferate, but we are also seeing consumers place deposits in emerging platforms like Apple, which generated more than $1 billion in deposits within its first four days, further reducing the dollars in circulation for community banks.

Deposit growth will be a challenge in the coming years for community banks that depend on everyday consumers and poses an existential threat to our future. Over the past few years, MBC has optimized the balance sheet and cost of funds by running near a 100% loan-to-deposit ratio. Over the past 12 months, MBC has implemented a variety of deposit growth strategies, thereby reducing the loan-to-deposit ratio to approximately 93%. MBC's five-year forecast includes deposit growth strategies to further reduce the loan-to-deposit ratio to 85% and shift the mix of deposits by increasing non-maturity deposits to further reduce reliance on certificates of deposit (CDs) and wholesale funding. Our focus will be on markets where there will be barriers to entry for big-tech, emerging industries that need strong treasury management functions and leveraging more deeply our mission-purpose and advantages in being hyper-local.

Additionally, Rising Bank, MBC's digital branch, has proven to provide a competitive advantage over others seeking liquidity by building a nationwide channel for sticky deposit growth. Rates paid on deposits raised through this channel are higher than rates paid in our lower-cost brick-and-mortar branches, although they are historically below brokered CD rates and Federal Home Loan Bank advances. The flow of deposit growth can be turned up or down depending on deposit gather and liquidity needs.

Like other financial institutions, MBC will be challenged to raise and retain deposits. Our ability to combine digital innovation of modern banking with the personal touch and deep community ties of a local community bank (relationship banking) may ensure our continued relevance and success in the communities we serve. Deposit growth strategies will be more intentionally focused on expanding existing relationships and further penetrating untapped opportunities in St. Louis and other business development office markets, while we will leverage our digital channel as needed to supplement deposit growth and liquidity.

How are you thinking about the competition for deposits and loans in today's interconnected and digital economy?

Loyalty that once existed in banking is eroding. All banks will be faced with challenges in raising and retaining deposits, as some consumers elect to move their accounts to the largest financial institutions deemed to be too big to fail, as well as fintechs and nontraditional competitors. The latter are intensifying competition for deposits by offering technology-driven solutions with attractive rates and seamless digital experiences that appeal to modern customers, particularly younger demographics. To compete, community banks will have to adopt technology and the right level of intensive personal service to improve the customer experience. Community banks are the lifeblood of local communities and serve as the engine supporting economic growth.

Even so, many customers can have short-term memories about the importance of these institutions. Over the past four years, MBC has intentionally invested in setting up the systems to support online deposit account opening and loan applications to improve the customer experience. We believe competition for deposits and loans will continue to increase and pose challenges across the industry. This said, MBC is doubling down on our "bank local" message and our strength in relationship banking, delivering high-tech and high-touch customer experiences that serve the toughest markets and Main Streets in St. Louis and beyond.

What legislative, regulatory and/or supervisory responses do you expect to surface in response to the March bank closures?

Legislative: There has been a good deal of speculation about legislative responses to the March bank closures. These include reinstating various rules that formerly applied to banks with more than $100 billion in assets, namely enhanced liquidity requirements and stress testing, annual supervisory capital stress tests, "living wills" for the resolution of the bank in a failure, increased capital levels and expanding long-term debt requirements for a broader range of banks. Who knows what will occur with a divided House and Senate who struggle to align on most things?

Regulatory/Supervisory: Based on the Government Accountability Office review of the bank closures, which indicated regulators identified issues but were not proactive in taking steps to correct these issues, the following could result going forward:

- Increased level of reporting of bank data in terms of interest-rate risk and liquidity
- Revised examination guidance for liquidity, interest-rate risk, concentrations and risk management governance
- Examiners more apt to cite banks for matters requiring attention with quick deadlines to address these issues
- Increased capital/liquidity expectations for banks that demonstrate higher than peer liquidity/interest-rate risk; in addition, for banks with concentrations noted, requirements for heightened capital levels and monitoring
- Regulatory requirements currently for larger banks applied to smaller banks
- An insistence that banks work through the so-called stigma and maintain more robust borrowing lines from the Federal Reserve, allowing them to access funds more quickly to match the speed of the internet

What potential responses do you see as constructive or harmful to your institution and to the community banking industry?

Constructive

- Increased customer understanding of their bank's financial condition
- Enhanced risk management systems for banks

Harmful

- Reduced bank profitability
- Potential decrease in lending due to potential regulatory guidance on capital and liquidity levels
- Increase in operating costs due to regulatory requirements forcing additional systems/personnel for risk management reporting and compliance
- Loss of innovation in new financial/lending products due to regulatory concerns
- Loss of business to larger banks that can handle increased regulatory requirements and have access to lower-funding sources

Brent Vidrine

President, CEO and Chairman, Bank of Sunset and Trust Co.
Sunset, Louisiana

Brent Vidrine is the chairman of the board, president and CEO of Bank of Sunset and Trust Co. in Sunset, Louisiana, a position he has held since 1997. Prior to joining Bank of Sunset, Vidrine was an internal auditor with Hibernia Bank in New Orleans, Louisiana. He has served as the chairman of the board for Louisiana State University at Eunice (LSUE) Foundation's Finance Committee, the Lafayette Sertoma Club and for Vision St. Landry. Vidrine also has served as a member of the board of directors for the LSUE Foundation and the Louisiana Bankers Association. Vidrine earned his Bachelor of Science in finance from Louisiana State University and his MBA from Tulane University. He is currently a member of the CSBS Bankers Advisory Board.

Many labor market surveys continue to indicate the challenge of attracting and retaining talent. In this environment, how does your institution recruit and retain the next generation of bankers?

Being from a smaller community, I think maybe it's a little different for us. Right now, with our bank, we have both seasoned and young talent. We're very fortunate in that we don't have a lot of employee turnover. Obviously, the world's different today, and young workers want to make a difference, and they want a work plan to follow that leads to growth in a career path. I totally agree with that thought process. You obviously have to be competitive with a compensation package, but you also have to provide these future hires with a path going forward. This includes timelines, and how you are going to get them to where they want to be. We try to promote from within and really haven't had hiring issues. For our bank, the hiring process hasn't been as difficult as for banks in the larger markets. For example, we have not had to face the work-from-home issue.

What has been the impact of the rapid interest rate rise on your institution, and what lessons have you taken away from this experience?

We are experiencing unprecedented times with the rapid interest rate increases over the past year or so. For our institution, this rapid rise in rates has been bittersweet because of the structure of our bank. Because we are an asset-sensitive institution, the rapid rise in rates has been positive for earnings and the net interest margin, but negative in terms of the cost of funds and the outflow of deposits.

As stated, the rise in rates has provided a positive effect on our earnings and net interest margin (NIM). In fact, our net income is up 17% from last year at this time. We went from a NIM of approximately 3.5% in 2022 to about 4.15% as of the end of June 2023. So overall, the top line and bottom line results have been very positive. If I look at the negative impact, it's been on competition for deposits for our bank, mostly in the brokerage area and from LAMP, the Louisiana Asset Management Pool, which is essentially a money market fund to which municipalities can go with public funds. LAMP pays premium rates, and we lost a significant deposit holder to the fund because we couldn't compete with the rate.

The decrease in deposits, coupled with an increase in loan demand, is really starting to strain our liquidity. Over the past few years, we were accustomed to carrying high amounts of liquidity on the balance sheet, particularly with the COVID programs in place.

The biggest lesson is not so much a lesson learned as it is a reiteration of a past principle: In a low-interest-rate environment, we need to stay focused and disciplined on a balanced investing approach.

What is your outlook with respect to funding and liquidity for your institution over the next three years? What changes do you foresee in your ability to raise and retain core deposits?

For the foreseeable future, we're going to continue to battle it out for deposits. There's no question. There are a lot of competitive pressures out there. With loan demand still fairly strong, we'll have to continue to be very proactive in managing liquidity. In addition, we'll have to manage interest-rate risk. Wholesale funding has become very important to institutions. Banks are tapping into those sources, and it will be a viable product for the foreseeable future. Our institution is not going to be an exception. We will have to take advantage of the products offered by the Federal Home Loan Bank, the [Bank Term Funding Program] and the Fed discount window or other options. However, with a projected recession on the horizon, depending on the severity and if it is a hard or soft landing, the funding/liquidity landscape may change significantly over the next year or so.

How are you thinking about the competition for deposits and loans in today's interconnected and digital economy?

We're fortunate enough to be in a position where we're able to focus on pricing and not really deviate from it a whole lot. For our existing customers, we can factor in their current deposit relationship and come up with a net yield and make an informed decision as to whether it is feasible to take in or keep the deposits. We have a similar system in place for loans, and it drives our decision-making on pricing.

A few years ago, it was not difficult to raise deposits if you were willing to be very competitive with pricing. The challenge may have been to retain deposits because customers were always going after the highest rate. If you were not willing to offer a very competitive rate, then the depositor was, in all likelihood, going somewhere else. If you were willing to pay up, you could keep the deposits.

In the future, while we will have to offer deposit products that are very competitive, we will also be forced to offer all of the technological advances that go with the products. We will be forced to create platforms comparable to those of fintech companies, which make it effortless for consumers and businesses to do their banking and move money around. For community banks, this will require core service providers to get on board with the necessary enhancements. At this point, the core service providers are not there yet; thus, the industry is handcuffed. I don't know how you can compete in this space without cooperation from the core providers.

What legislative, regulatory and/or supervisory responses do you expect to surface in response to the March bank closures? What potential responses do you see as constructive or harmful to your institution and to the community banking industry?

I think there will be more scrutiny. We will likely see a bit of an overreaction. There's going to be a greater emphasis on interest-rate risk with the increasing cost of funds, unrealized losses on securities and uninsured deposits. I hope that community banks are not severely impacted by the overreaction of the regulators.

From a positive standpoint, it will force customers to evaluate their funding plans. In all likelihood, it will force institutions to add additional sources of funding. I believe this will be a positive development. In addition, it will make institutions take a step back and look at their interest-rate risk policies and practices, as well as their makeup and reliance on uninsured deposits. These are all good things. Regarding any potential harmful effects, I can see a scenario in which all banks will be required to carry more capital on their balance sheets. While this response is intended for the larger institutions, I am concerned that it will filter down to all institutions. Also, if unrealized losses on securities are included in the capital calculation, this could certainly be harmful.

Not all banks are the same, and small community banks do not have the risk profiles that led to the failures. We certainly hope that the regulators will exempt community banks with low-risk profiles from additional regulation.

Andrew West

President and CEO, Eagle Bank
Polson, Montana

Andrew West is the president and CEO of Eagle Bank in Polson, Montana. West has an extensive history in the banking industry, having served as the vice president of Commercial Lending with Community Bank Inc. in Missoula, Montana, as well as the branch manager with Valley Bank of Arlee, in Arlee, Montana. He is currently a member of the FDIC Advisory Committee on Community Banking, and a member of the Montana Independent Bankers Association board and the Salish Kootenai College Institutional Advancement Advisory Board. He previously served as a member of the Federal Reserve Bank of Minneapolis' Community Depository Institutions Advisory Council. He received a bachelor's degree in business administration in accounting from the University of Montana and holds a graduate degree in banking from the Pacific Coast Banking School.

Many labor market surveys continue to indicate the challenge of attracting and retaining talent. In this environment, how does your institution recruit and retain the next generation of bankers?

In my opinion, there are two factors that weigh very heavily on a bank's ability to attract and retain talent. The first and foremost of those two factors is a bank's culture. The second one is high compensation. To have a good culture, you need to have an organization that is oriented toward improving the lives of your staff through professional development and flexibility with scheduling. I think employers, or banks, need to realize that it's an employees' market right now. The only way you can really attract top talent is to offer a workplace that's enjoyable and that contributes to their professional development. I think a bank that wants to be successful has to pay better than the competition and has to provide a workplace that's cohesive with the employees' professional goals and flexibility with regard to their personal lives. You have to have a good coach. You can have a good culture with low pay and lose talented people. You can pay high wages with a bad culture and still lose people.

If you have a great culture and you pay better than your competitors, you'll retain top talent. I think we've done a really good job of that here. As the CEO, I would say my No. 1 focus is culture, because I think when you have a great culture, and you pay well, you attract really good people. The performance of the bank is then a byproduct of having great people working for you.

What has been the impact of the rapid interest rate rise on your institution, and what lessons have you taken away from this experience?

This is something that I've been giving a lot of thought to lately, not because of what it's done to my bank, but because of what it's done in my colleagues' banks. This is because we are owned by the confederated Salish and Kootenai tribes. They're also our largest depositor. Because of this, we haven't really seen the runoffs that have been seen at other Montana banks. We have deposit stability that a lot of other institutions in Montana do not enjoy. In Q1 2023, growth was a negative 13.1% across our 37 banks in Montana; 29 out of 37 banks had deposit runoffs in Q1. So there is much concern there.

What is your outlook with respect to funding and liquidity for your institution over the next three years? What changes do you foresee in your ability to raise and retain core deposits?

I think we're not anywhere close to the end of the crisis when it comes to liquidity. A lot of banks are suffering because their depositors are chasing interest rates, and the banks have been reluctant to raise their deposit rates because of the issue of net interest margin. So a lot of depositors have left. I think many of my colleagues have been surprised at how quickly and readily and easily their customers just abandoned ship. I think this has put a lot of banks in a position where they are borrowing money from the Fed, from the Bank Term Funding Program or from overnight funds, and it's costing them a lot and negatively impacting their net interest margin.

With rates being higher, there's the problem of loan demand dropping in a lot of areas. People just don't want to borrow money. It makes a lot of projects not work with the current cost of construction and things. So the banks aren't really having much success adding higher yielding credits, or in offsetting these new increased costs of funds. I think we're going to see continued compression of the net interest margin over the next few quarters until, hopefully, the Fed reverses course and things change. It's a little nerve-wracking, I think, for a lot of these guys.

Again, we're just really blessed. Today we have $36 million in off-balance-sheet deposits through IntraFi. So we are like 60% liquid. You can't see that in my call report, but it's there and it's just a blessing. Sometimes it's better to be lucky than good. I say that all the time. We just landed in a good spot. But I am worried about the industry. I'm worried about the impacts on small- and medium-sized banks. I think a lot of the big banks lay off a lot of staff. They do what they have to do. We've already seen it here for one of our biggest banks. If they haven't already, they're in the process of laying off all of the mortgage department. They're just going to outsource it as needed. This negatively impacts the lives of a lot of people, so it's concerning to me. We're just fortunate and blessed to be working at a bank whose owners have a lot of money, and they keep it in their own bank. That's just something that I did not anticipate when I started this job eight years ago—how important that might become later on in my career. I'm certainly realizing it now, and I'm counting my blessings every day.

My outlook is that I'm going to be remaining exceptionally liquid for the next three years. I've had a lot of discussions with the director of financial management for the tribes. He has a finance background and understands the importance of the bank maintaining its liquidity. He also understands that his bosses, who are the tribal council, would probably be exceptionally upset with him if he took all the money out of the tribally owned bank and moved it somewhere else.

Do I foresee my ability to raise and retain core deposits changing? I don't. The only risk that I really see is a scenario in which the tribes, who get a lot of their money from the federal government—that's somewhat dependent upon budgets and continuing resolutions—find themselves in a liquidity crunch if their budgets retract. So I'm watching that very carefully and managing the growth of our bank with that in mind.

We're one of the most heavily banked towns in all of Montana as far as I know. Eagle Bank is located in Polson, Montana, where we have six major financial institutions, and we have a population of roughly 5,500 people; that's roughly 900 people per bank. Helena, Montana, in comparison, has 40,000 people and 14 banks; that's roughly 2,850 people per bank. So we're exceptionally overbanked. It's really hard for me to compete with the two biggest banks and the biggest credit union in our state in terms of consumer deposits. And we're certainly not going to do it on price. If we're going to do it, it's going to be on service, because we're smaller, we're flexible and we're nimble, and we have what I believe to be really exceptional customer service. It's impossible for me to go up against any of the bigger banks with regard to buying the business in terms of selling deposits at really high rates or whatever it is that they have the ability to do, because they have way more product lines than I do.

To my knowledge, we are the only bank in the state of Montana that has discontinued the practice of charging overdraft fees, and this may help us some. In fact, not only have we stopped charging overdraft fees, but all of our business accounts have no credits and no per-item charges. The idea is to simplify everything, so everyone understands it, and it's very easy to work with. So we may see some migration.

Also, we work with IntraFi, and we can ensure up to $175 million of customer deposits with FDIC insurance through our relationship with that corporation. So this may be something we try to leverage here in the near future, because I know there's a lot of uncertainty among depositors. Also in our area, there are probably not a lot of consumer deposit accounts that have more than that, just by the nature of our economy.

We use [IntraFi] all the time. We have $36 million in sold deposits. It gives us this giant, deep well of liquidity. So if I start making some loans and I need to fund them, I can basically pull those deposits back onto the balance sheet as needed with 24 hours' notice. So, that's really nice.

What legislative, regulatory and/or supervisory responses do you expect to surface in response to the March bank closures? What potential responses do you see as constructive or harmful to your institution and to the community banking industry?

Honestly, the regulators do a pretty good job. I was a little taken aback when Silicon Valley failed, because I know if I were engaged in a behavior that way, that my regulators would have hung me up. So I'm not quite sure how this got by everybody. But I expect that there's going to be a much greater attention to detail with regard to interest-rate risk management. It's already an area that is heavily monitored and watched. But when you look at the circumstances surrounding the failure of Silicon Valley Bank in particular, in my opinion, there were things that were being done that were not in conformance with safe and sound banking practices, as they pertain to interest-rate risk management. I think we're going to see a lot of attention on that, which needs to happen because it's important.

So I'm sure there will be more regulation. I think that seems to be the regulators' answer to everything—more regulation. But this is a double-edged sword. It's necessary, but it can be awfully onerous to us small banks, particularly when we are not engaging in some of the risky behaviors that spawn these new regulations. They burden us. It's a challenge. I think we need a greater focus by the regulators on rightsizing the regulations in accordance with the size and scope of the institutions.

It's not one size fits all. From the operational standpoint of what we're doing compared to what Silicon Valley Bank or Signature Bank were doing, we're nothing like that. So I hope that when they come up with whatever comes out of this, that they take a look at who their subjects are before just dumping more regulations on us.

While I believe regulation is necessary, it's also extremely burdensome, particularly things like BSA/AML and a variety of other things. With regard to safety and soundness, common sense would say that a bank manager or a CEO would do everything he/she could to operate his/her bank in a safe and sound manner—never compromising safety and soundness for profitability. But it's evident to me that without those regulations and without the watchful eye of the regulators, we would probably see more train wrecks. So I'm glad the regulators were there. I'm glad that we have regulation. I just hope that when the new regulations come out, they consider who their audience is and that they regulate the people that need the regulation and not everybody "just because." There's quite a strong sentiment among small community banks that the regulators would just like to see us all disappear. I am sure CSBS doesn't feel that way, but when I am around my colleagues, that's the vibe I get that they just kind of feel like we're more trouble than we're worth sometimes. And our argument goes back to the fact that we provide essential and useful functions to the small communities across the country that might not get the same level of service from the large banks, like Wells Fargo or Citibank.

When I started here eight years ago, I think there were 64 banks in Montana. Now we're down to 37.

Some of the big banks, my competitors, they deem themselves community banks—they give tons of money to the Boys & Girls Clubs, etc. But if you go in there and you need to borrow some money and you don't check all of their boxes, you're getting shown the door, right? But if you come to me because I'm a small bank and I know you because I've lived here the last 25 years, we find ways to mitigate risks and make those loans. Ultimately, that is what defines a community bank and why community banks are so incredibly important. If it were not for banks like mine, a lot of these people who are really creditworthy would not get the financing they need. It can't be understated how important this is. Yes, it's nice that we all donate money. But that doesn't make you a community bank. What makes you a community bank is knowing your customer and finding a way to help that person. Everybody walks through our door with a problem; how effective are we at solving it? This is where we shine.

I'm really grateful to be a community banker because I love that I can sit down with my customers and go through and explore every option with them; find a way to do it.

I tell people that all the time. If it's doable, if it's possible, I'll figure it out because I've got the time. I'm not so overrun with things that if there's an issue that's not an easy fix, I'd have to let it go. I think that's really the value that community banks bring.