

Jordan Williams/Thinkstock

Community Banking | 2018

in the 21st Century

Research and Policy Conference

CO-SPONSORED BY:



Community Banking in the 21st Century

Sixth Annual Community Banking Research and Policy Conference

Co-sponsored by the Federal Reserve System, the Conference of State Bank Supervisors
and the Federal Deposit Insurance Corp.

Oct. 3-4, 2018, at the Federal Reserve Bank of St. Louis



Acknowledgments:

This publication was made possible by the collaborative efforts of state bank supervisors, community banks, the Conference of State Bank Supervisors and the Federal Reserve System. The *Community Banking in the 21st Century* National Survey was administered by state bank commissioners in 37 states. A total of 521 community bankers participated in the survey. Interviews with community bankers, referred to in this publication as “Five Questions for Five Bankers,” were conducted by 29 state bank supervisors in 28 states from April to July. Participation in both the 2018 National Survey and the “Five Questions for Five Bankers” discussions would not have been possible without the efforts of the following state bank commissioners and members of their staffs:

Alabama

Mike Hill, Superintendent of Banks
Alabama State Banking Department

Arkansas

Candace A. Franks, Bank Commissioner
Arkansas State Bank Department

California

Jan L. Owen, Commissioner
California Department of Business Oversight

Colorado

Patty Salazar, Commissioner
Colorado Division of Banking and Division
of Financial Services

Connecticut

Jorge Perez, Commissioner
Connecticut Department of Banking

Georgia

Kevin B. Hagler, Commissioner
Georgia Department of Banking and Finance

Hawaii

Iris Ikeda, Commissioner of Financial Institutions
Hawaii Division of Financial Institutions

Idaho

Gavin M. Gee, Director of Finance
Idaho Department of Finance

Illinois

Bryan A. Schneider, Secretary
Illinois Department of Financial and
Professional Regulation

Indiana

Thomas C. Fite, Director
Indiana Department of Financial Institutions

Iowa

Ronald L. Hansen, Superintendent
Iowa Division of Banking

Kansas

Miki W. Bowman, Commissioner
Kansas Office of the State Bank Commissioner

Kentucky

Charles A. Vice, Commissioner
Kentucky Department of Financial Institutions

Louisiana

John P. Ducrest, Commissioner of Financial Institutions
Louisiana Office of Financial Institutions

Maryland

Antonio P. Salazar, Commissioner
Maryland Office of Financial Regulation

Massachusetts

Terence A. McGinnis, Commissioner of Banks
Massachusetts Division of Banks

Michigan

Karen K. Lawson, Director, Office of Banking
Michigan Department of Insurance
and Financial Services

Minnesota

Jessica Looman, Commissioner
Minnesota Department of Commerce

Mississippi

Charlotte N. Corley, Commissioner
Mississippi Department of Banking
and Consumer Finance

Missouri

Lee Keith, Commissioner
Missouri Division of Finance

Montana

Melanie G. Hall, Commissioner
Montana Division of Banking and
Financial Institutions

Nebraska

Mark Quandahl, Director
Nebraska Department of Banking and Finance

Nevada

George E. Burns, Commissioner
Nevada Financial Institutions Division

New Mexico

Christopher Moya, Acting Director
New Mexico Financial Institutions Division

New York

Maria Vullo, Superintendent
New York State Department of Financial Services

North Carolina

Ray Grace, Commissioner of Banks
North Carolina Office of Commissioner of Banks

North Dakota

Lise Kruse, Commissioner
North Dakota Department of Financial Institutions

Ohio

Kevin R. Allard, Superintendent
Ohio Division of Financial Institutions

Oregon

Jacob P. Mundaden, Program Manager
Oregon Division of Financial Regulation

South Carolina

Robert L. Davis, Commissioner
South Carolina Office of the Commissioner of Banking

South Dakota

Bret Afdahl, Director of Banking
South Dakota Division of Banking

Tennessee

Greg Gonzales, Commissioner
Tennessee Department of Financial Institutions

Texas

Charles G. Cooper, Banking Commissioner
Texas Department of Banking

Texas SML

Caroline C. Jones, Commissioner
Texas Department of Savings and Mortgage Lending

Utah

G. Edward Leary, Commissioner of
Financial Institutions
Utah Department of Financial Institutions

Virginia

E. Joseph Face Jr., Commissioner of
Financial Institutions
Virginia Bureau of Financial Institutions

Washington

Gloria Papiez, Director
Washington Department of Financial Institutions

Wisconsin

Jay Risch, Secretary
Wisconsin Department of Financial Institutions

Wyoming

Albert L. Forkner, State Banking Commissioner
Wyoming Division of Banking

Table of Contents

Letter from Randal K. Quarles	5
Foreword from Charlotte N. Corley	6
2018 National Survey	9
Five Questions for Five Bankers.....	43
Arkansas	44
Connecticut	45
Georgia	46
Hawaii	47
Idaho	48
Illinois.....	50
Indiana.....	51
Kansas	52
Kentucky	53
Louisiana.....	54
Massachusetts	55
Minnesota	56
Mississippi.....	57
Missouri	59
Montana.....	61
Nebraska	62
New Mexico	63
North Carolina	64
Ohio	65
Oregon.....	66
South Dakota	68
Tennessee	69
Texas	71
Utah	73
Virginia.....	74
Washington.....	75
Wisconsin	76
Wyoming.....	77

Letter from Randal K. Quarles

This year marks 10 years since the height of the financial crisis—an event that sparked the Great Recession and dramatically changed the banking landscape. While the resiliency of the financial system has strengthened in the years since the crisis, regulatory costs have also grown, some of which have pushed through to community banks.

Regulatory burden and its effect on community banks have been the subject of much discussion during the Federal Reserve/Conference of State Bank Supervisors/FDIC research and policy conference, now in its sixth year. It has also been an issue that has consistently risen to the top of the survey of community bankers and analysis that are conducted each year in conjunction with the conference. Of note, for the first time since the inaugural survey, respondents to this year's survey now report that regulatory costs have leveled or are decreasing somewhat. Moreover, community bankers are optimistic that the passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act will further reduce regulatory burden while still maintaining the integrity of the financial system.

The issues facing community banks continue to change, and we have more work to do to further understand the implications. I look forward to continuing to build on our knowledge of issues confronting the industry as we combine the perspectives of researchers, regulators and community bankers.

Randal K. Quarles

*Vice Chairman for Supervision
Board of Governors of the Federal Reserve System*

Foreword from Charlotte N. Corley

Compliance costs are coming down. That is one key finding from the Conference of State Bank Supervisors' survey of community banks, the largest independent survey of community banks operating in the United States. After years of increases, this year's survey found that compliance costs for community banks actually declined by 13 percent.

Creating more awareness and understanding about community banking is a primary focus of this research report and the related conference that is co-sponsored by the Federal Reserve, CSBS and the Federal Deposit Insurance Corp. For the past six years, we have gathered leading academics, regulators and bankers to quantify and analyze the economic conditions of community banks. And then we have shared and discussed our report and related conference research with key policymakers and other regulators in Washington.

As regulators, we believe that nurturing a diverse financial system where risks can be more widely spread involves tailoring regulation to the risks posed by individual institutions. Thus, if we agree that community banks perform a vital role in this diversification—and we do—they should have a regulatory regime that is appropriate for them and not be subject to the same controls as larger institutions that pose systemic risk.

Because of the data and analysis that stem from our research report and annual conference, policymakers have been more informed in shaping legislation such as the recent bank regulation bill approved by Congress earlier this year. We look forward to continuing to assist policymakers in the years to come.

Charlotte N. Corley

*Chairman, Conference of State Bank Supervisors
Commissioner, Mississippi Department of Banking and Consumer Finance*



2018 National Survey

2018 National Survey

Introduction

Community banks finally may have turned the corner on costs incurred in regulatory compliance. After years of going up, costs now appear to be going down.

Compliance costs in most operational categories, expressed as percentages of categorical costs, declined among the 521 banks surveyed earlier this year by the Conference of State Bank Supervisors (CSBS) and state regulatory authorities. The survey findings, and supplemental state regulatory authorities' interviews with community bankers, are part of the sixth annual *Community Banking in the 21st Century* research and policy conference. The goal of the conference is to provide a comprehensive view of key issues facing the industry.

Overall, inferred compliance costs for the community banking industry declined in 2017 after increasing in each of the previous three years. This may be related, in part, to rollbacks of regulations that were phased in following a regulatory review under the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). The review, which began in 2014, focused on regulatory burden, especially for smaller banks.

"The trend toward regulation being scaled to the size of the institution is positive," one surveyed banker said. Another banker, more generally, noted "an attitude change in Congress and [among] regulatory agencies in regard to reducing the regulatory burden in the financial industry."

In addition to regulatory issues, this year's survey addressed trends in small business and other lending, banking services, mergers and acquisitions, management succession, and financial technology. Assessments of the latter varied. Some bankers were enthusiastic about technological opportunities, while others were wary of their costs. Most of them said they had not yet felt a predicted crush of fintech competition.

This year we introduce a slightly different format to our report. Earlier editions were structured narratively, with survey results interwoven with background from other sources. This year we focus directly on the questions posed to bankers, thereby allowing readers more direct insight into the responses provided.

Key Findings

- Inferred compliance costs for the overall community banking industry, which had been increasing in previous years, declined to an estimated \$4.7 billion.¹ Despite the decline, surveyed bankers cited the cost of regulations as a key factor in considering whether to accept acquisition offers.
- Management succession was considered at least a moderately important factor by two-thirds of bankers who were weighing acquisition offers.
- Online loan applications were offered by 39 percent of banks. A similar percentage did not offer them and had no immediate plans to do so.
- A majority of bankers said they were collecting and analyzing data in preparation for implementation of the Current Expected Credit Loss (CECL) model.
- Fintech firms were named as the primary current and primary future competitor in small business lending by, respectively, 0.2 percent and 6.9 percent of bankers. For consumer lending, the comparable shares were 1.6 percent and 14.9 percent.
- More than two-thirds of bankers said they rarely or never rely on in-house technology for online loans or other digital products.
- The vast majority of bankers said that, in response to competitive pressure for small business loans, they rarely or never eased terms by extending maturity, reducing collateral requirements, requiring fewer covenants or allowing more borrower leverage.

Endnotes appear on Page 40.

Background on the Survey

To develop the 2018 National Survey, CSBS staff members met with representatives from several Federal Reserve banks, the Federal Reserve Board of Governors and the academic community to identify current issues of relevance to community banks. Many, but not all, of the resulting questions were similar to those asked in earlier surveys, thereby offering an opportunity to compare responses over time.

This year’s survey was distributed by state banking regulatory authorities from April to July. The Survey Research Institute at Cornell University constructed the web interface used by the respondents, handled technical aspects of data collection and transmitted the data for analysis.

Our final sample consisted of 521 community banks in 37 states. Of those banks, the vast majority were state-chartered with assets of less than \$10 billion, a benchmark for community banks established under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”). The remainder consisted primarily of thrift institutions. Throughout this analysis, we will refer to all surveyed entities as “community banks.”

We provide background information on the surveyed banks in Figures 1 through 4. For comparative purposes, we have included industrywide breakdowns on all state-chartered banks where appropriate.

FIGURE 1
Survey Respondents as a Percentage of State-Chartered Community Banks and Thrifts by State

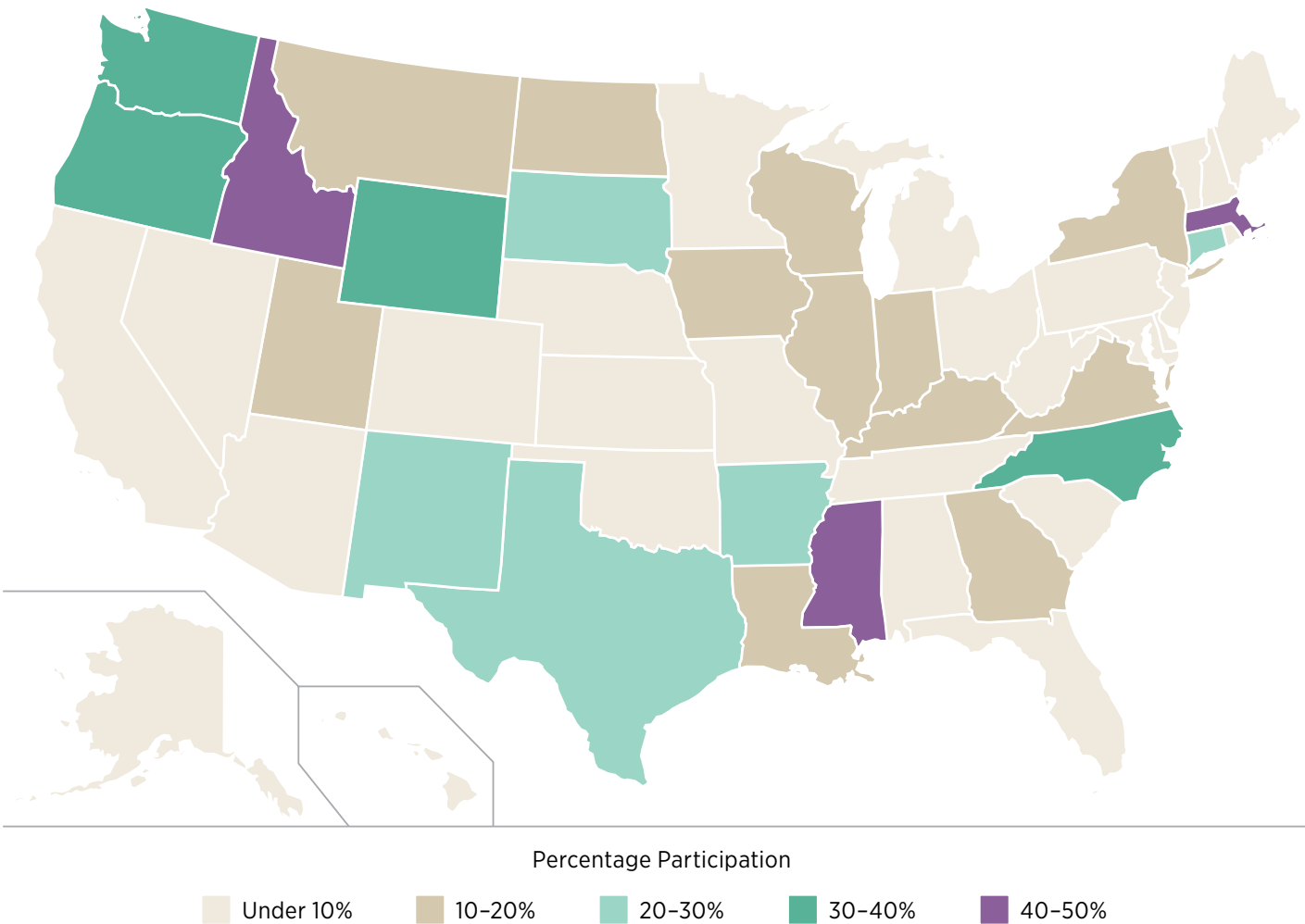


FIGURE 2

How does the survey sample compare to the general population with respect to size?

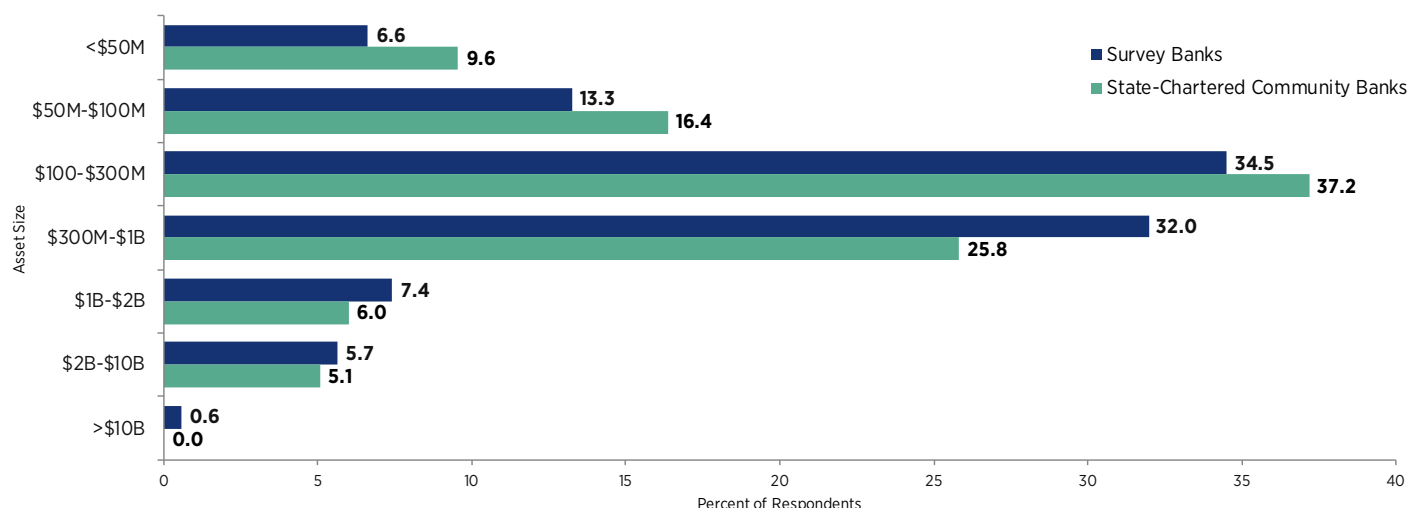


FIGURE 3

How does the survey sample compare to the general population with respect to the number of branches per bank?

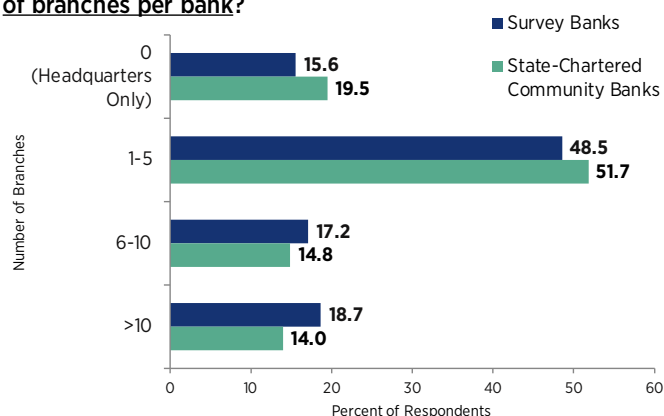
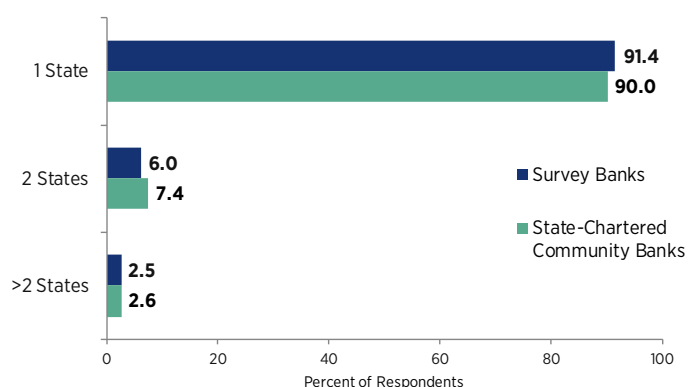


FIGURE 4

How does the survey sample compare to the general population with respect to the number of states served?



We acknowledge limitations of the survey:

- It was not distributed in every state.
- Respondents participated on a self-selected basis.
- The number of bank responses was small relative to the size of the industry.
- Banks were not required to respond to every question.²
- We do not conduct detailed statistical testing, which would be required to definitively quantify the extent to which surveyed banks were representative of the overall industry.

That said, the banks in our sample do appear to represent the industry in which they operate with respect to size, branching and diversification by state. From this perspective, they are useful as a barometer of conditions faced by many community banks.

Small Business Lending

Small business loans often are described as the lifeblood of community banks. Our survey offers insight into how community banks make decisions on these loans and how their decisions are influenced by, or exert an influence on, the markets in which they compete.

Several questions asked this year were also posed in last year's survey, with similar responses between years. Bankers reported that small-business lending decisions were influenced:

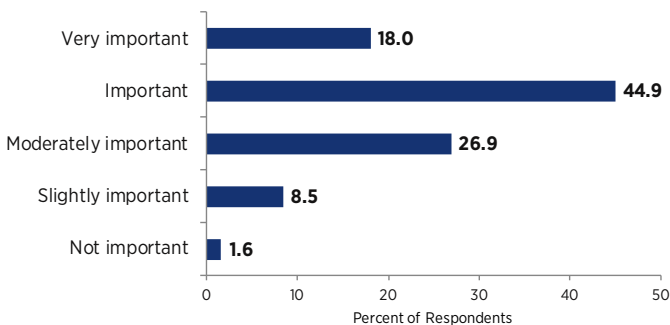
- *Very importantly* by the financial statements of businesses, business collateral and business owners' personal credit scores;
- *Importantly* by general business conditions, business owners' personal collateral, general business assets (not pledged as collateral), prior deposit relationships, and prior and potential lending relationships; and
- *Less importantly* by business credit scores and guarantees of the Small Business Administration (SBA).

FACTORS IN LENDING DECISIONS

- ▼ New questions this year examined more extensively the relationships between banks and their customers. They touched on longevity, breadth and exclusivity.

FIGURE 5

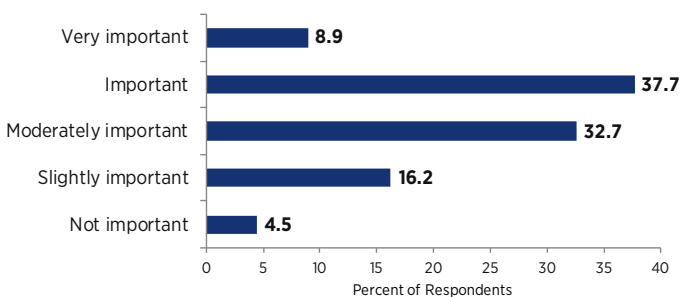
How important is the length of relationship in making a small business loan?



More than 60 percent of respondents said that the length of the relationship between lender and borrower was a very important or important factor in their decisions to make small business loans. This may afford a better opportunity, as one banker stated, to verify "standing in the community."

FIGURE 6

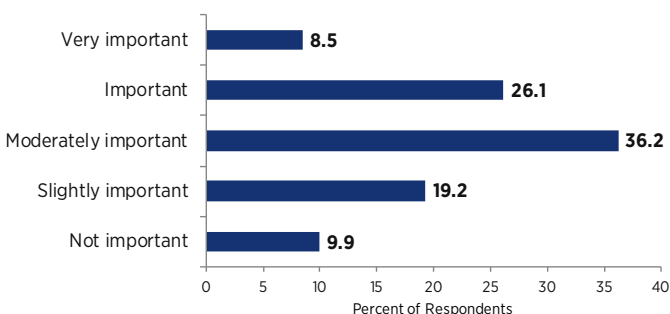
How important is the breadth of relationship (e.g., number of accounts) in making a small business loan?



The breadth of relationships—including the number of accounts a borrower maintains with the bank—was considered by nearly half of respondents to be a very important or important factor.

FIGURE 7

How important is an exclusive lending relationship in making a small business loan?



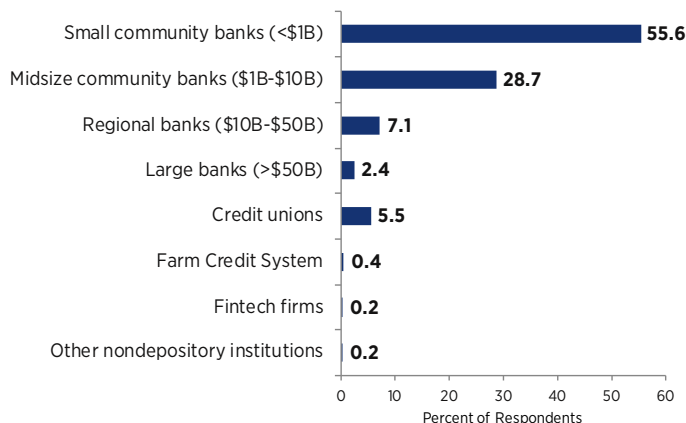
The exclusivity of relationships played a modest role in lending decisions. Only slightly more than one-third of respondents considered this a very important or important factor.

COMPETITION FOR SMALL BUSINESS LOANS

- Several questions centered on current and expected competitive conditions. Some of them were structured similarly to those concerning credit terms and standards that are part of the Federal Reserve's Senior Loan Officer Opinion Survey.

FIGURE 8

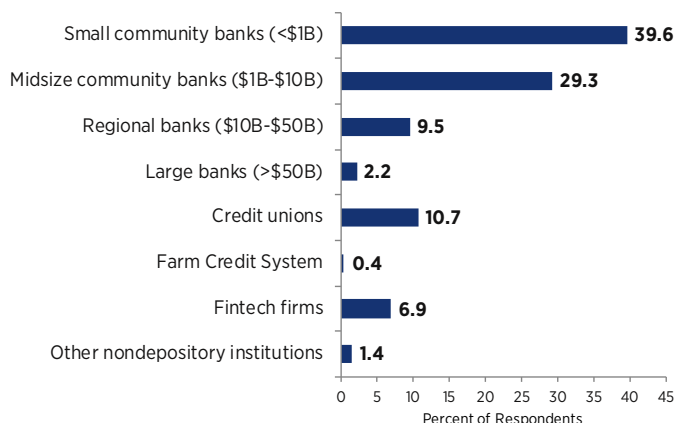
Who is your current primary competitor for small business loans?



Bankers agreed that the current competitive landscape for small business lending is dominated by other community banks, which were named the greatest source of competition by nearly 85 percent of respondents. Small community banks—those with assets of less than \$1 billion—were seen as particularly formidable.

FIGURE 9

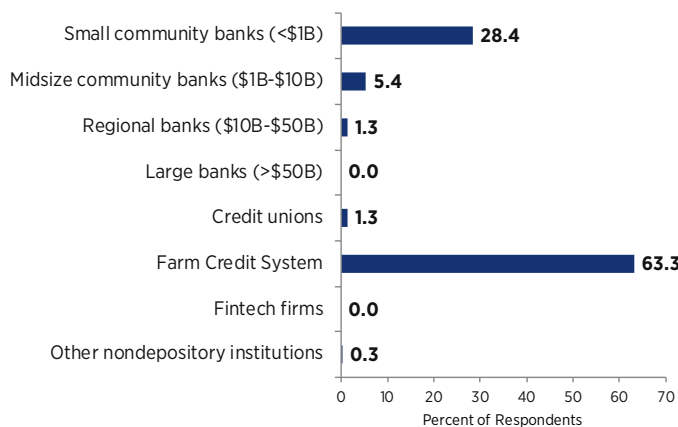
Who is your expected future primary competitor for small business loans?



With respect to future competitors, bankers foresaw larger roles for credit unions and, more noticeably, fintech firms. Results were almost identical to those reported in last year's survey.

FIGURE 10

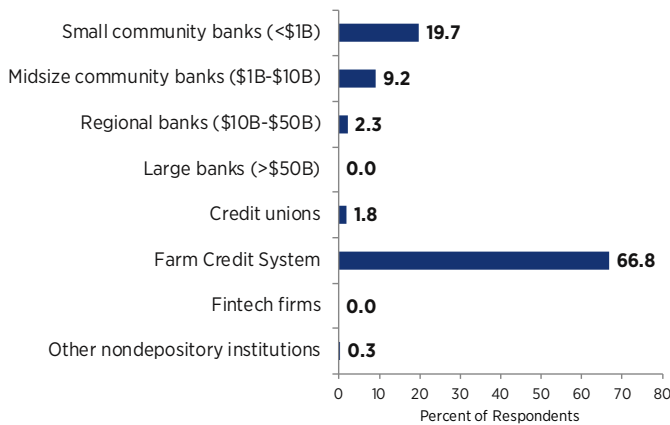
Who is your current primary competitor for agricultural loans?



Competition for agricultural loans, which are similar to small business loans insofar as farmers also are business owners, was dominated by the Farm Credit System. A government-sponsored enterprise, the Farm Credit System held \$259 billion in agricultural loans at year-end 2017; the banking industry, by comparison, held \$81 billion.³

FIGURE 11

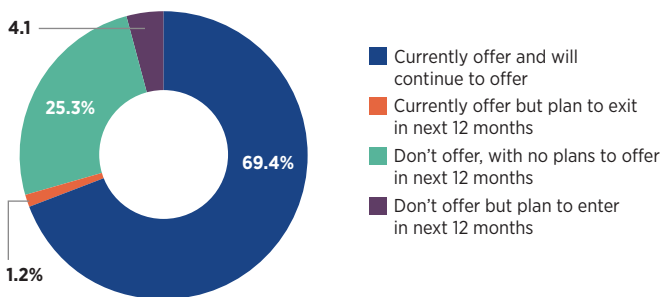
Who is your expected future primary competitor for agricultural loans?



The Farm Credit System's dominant role in agricultural lending (Figure 10) was expected to persist. One banker noted that "tax-exempt competitors are a disadvantage for us."

FIGURE 12

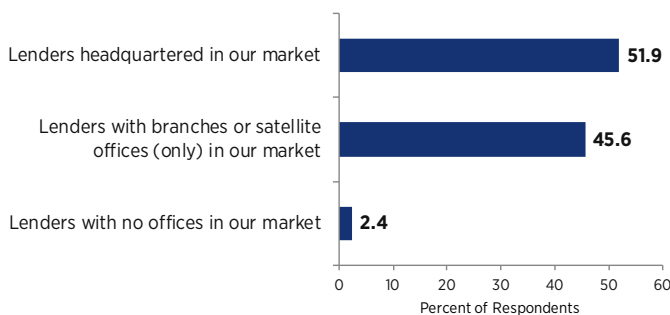
What are your intentions regarding Small Business Administration (SBA) loans?



SBA loans were offered by nearly 70 percent of community banks, similar to the share reported last year. Despite this apparent stability, some surveyed bankers pointed to concerns: One expressed the need to become "more proficient in SBA lending," while another complained of "poor service from the SBA."

FIGURE 13

Where does competition for small business loans primarily come from?



Bankers noted that competition for small business loans was largely local. Nearly all respondents said that their primary competitors were either headquartered in their market or maintained branch offices there.

RESPONSES TO COMPETITION

▼ The following survey questions explored the impacts of competition on lending terms. Bankers' responses are shown in Figures 14 through 19.

FIGURE 14
How often in 2017 did competition from other lenders cause you to ease lending terms on small business loans by lowering interest rates?

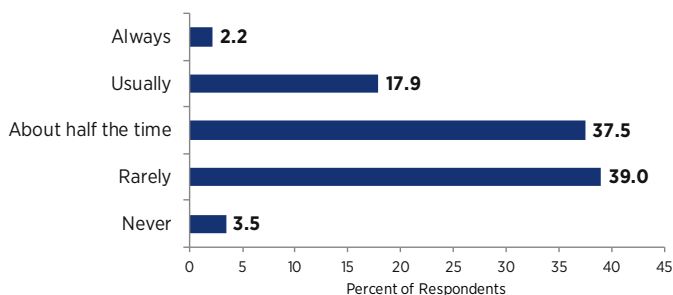


FIGURE 15
How often in 2017 did competition from other lenders cause you to ease lending terms on small business loans by lowering fees?

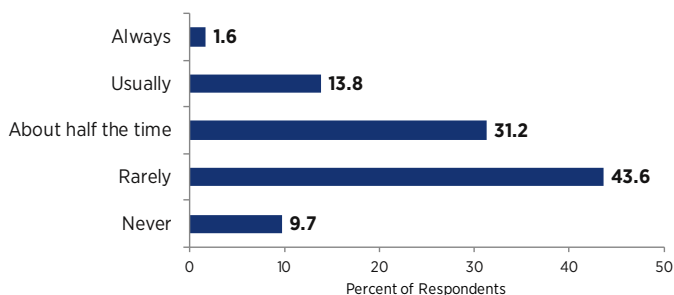


FIGURE 16
How often in 2017 did competition from other lenders cause you to ease lending terms on small business loans by extending maturity?

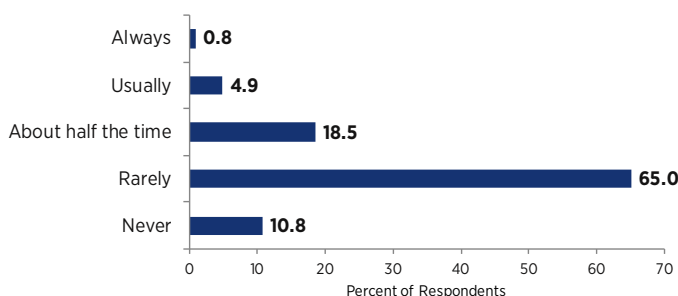


FIGURE 17
How often in 2017 did competition from other lenders cause you to ease lending terms on small business loans by reducing collateral requirements?

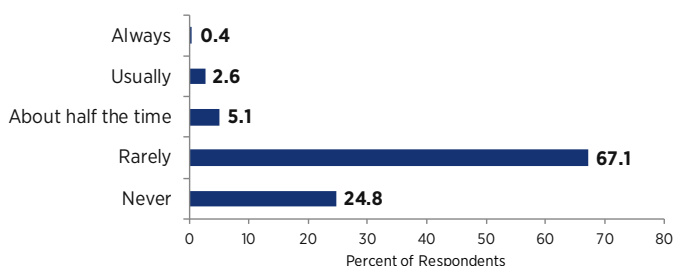


FIGURE 18
How often in 2017 did competition from other lenders cause you to ease lending terms on small business loans by allowing more borrower leverage?

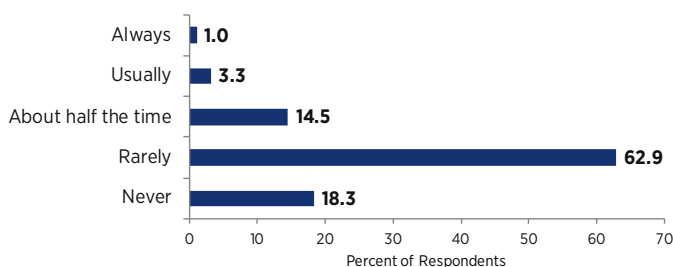
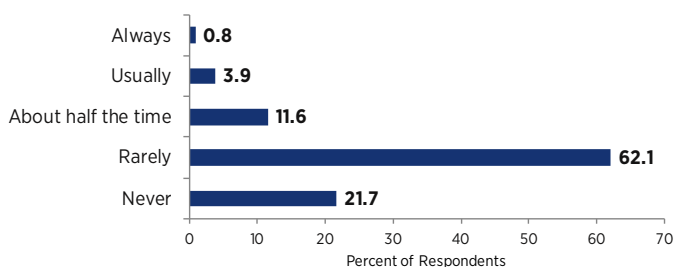


FIGURE 19
How often in 2017 did competition from other lenders cause you to ease lending terms on small business loans by requiring fewer covenants?



While more than 20 percent of respondents said that they always or usually lower interest rates on small business loans due to competitive pressure, twice as many said that they rarely or never do (Figure 14). The latter may reflect the opinion of one surveyed banker who said that “with existing customers, rates are generally accepted with little pushback.” Some bankers said that competition required them to be flexible on fees (Figure 15). In other areas, banks reported less sensitivity (Figures 16 through 19).

RELATIONSHIPS WITH BORROWERS

- Community bankers often establish close relationships with borrowers. This creates opportunities to offer advice in various areas, which are explored in Figures 20 through 26.

FIGURE 20

How often do you provide the additional service of long-term strategic advice to small business customers?

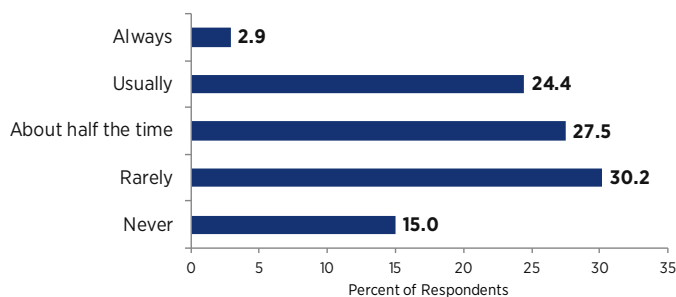


FIGURE 21

How often do you provide the additional service of general management advice to small business customers?

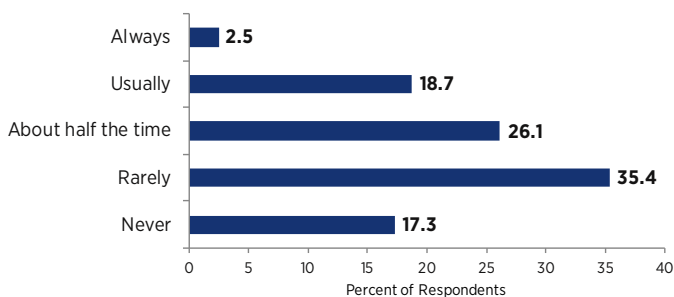


FIGURE 22

How often do you provide the additional service of connections to customers or suppliers to small business customers?

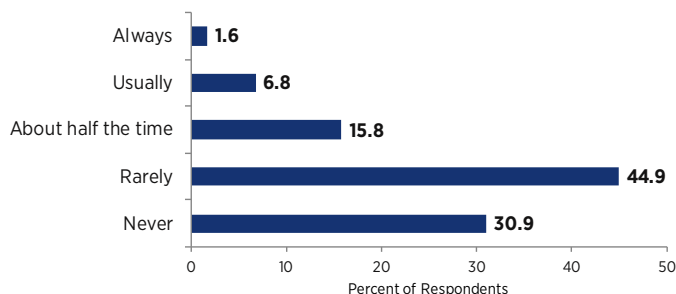


FIGURE 23

How often do you provide the additional service of product development advice to small business customers?

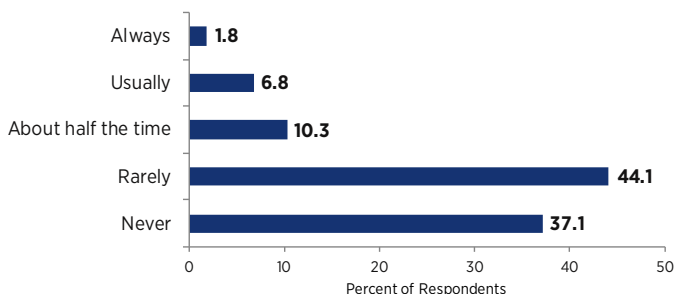


FIGURE 24

How often do you provide the additional service of operational advice to small business customers?

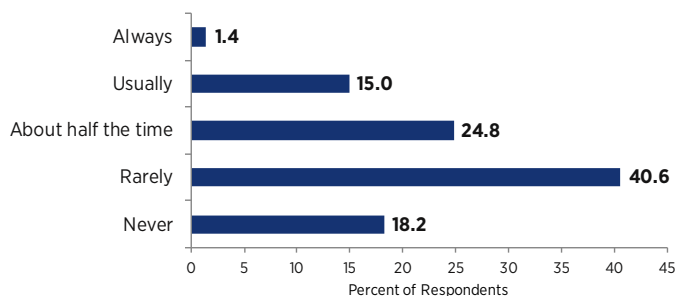


FIGURE 25

How often do you provide the additional service of wealth management advice to small business customers?

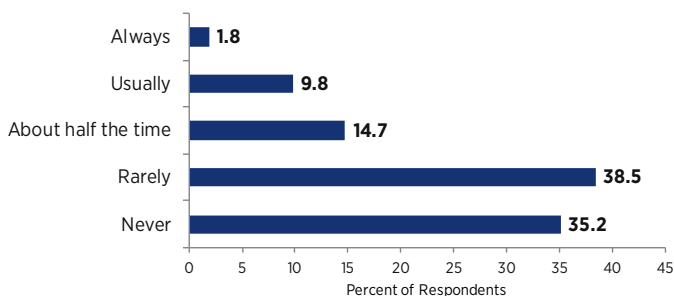
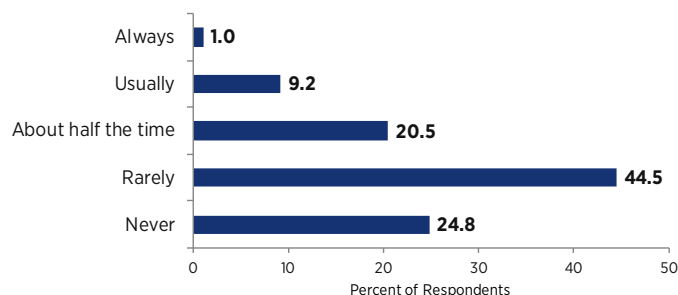


FIGURE 26

How often do you provide the additional service of management succession advice to small business customers?



Bankers said that they were most likely to offer advice in the area of long-term strategy (Figure 20). In all other areas, however, a majority of bankers said that they rarely or never offered advice (Figures 21 through 26).

Section Summary

The competitive environment for small business loans appears to be on the cusp of transformation. Currently, it is not a particularly reactive marketplace, insofar as surveyed bankers said that they seldom respond to competitive pressure by extending loan maturities, reducing collateral, increasing leverage or reducing covenants. This view is consistent with the comment of one banker who said, “Loans are based on the bank’s perspective with little third-party influence.”

In the future, pressure from fintech firms and other nondepository institutions is expected to intensify, with the percentage of surveyed banks naming these entities as primary competitors growing from a negligible percentage currently to more than 8 percent. As another banker said, “We are very concerned about unregulated participants competing for our customers.”

Loans Other than Small Business

Lending activities, aside from small business loans, are categorized in this section as:

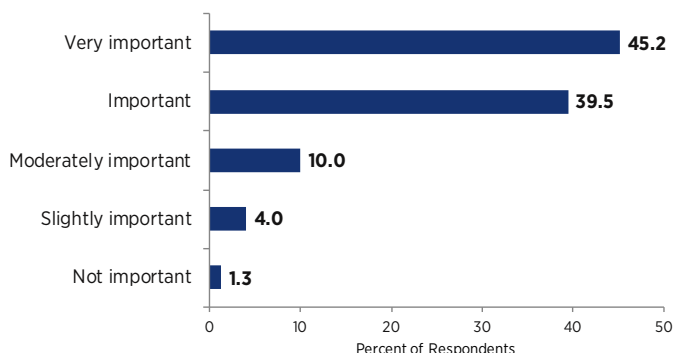
1. Loans currently offered that will continue to be offered;
2. Loans currently offered with plans to exit in the next 12 months;
3. Loans not currently offered with no plans to offer in the next 12 months; and

4. Loans not currently offered with plans to start in the next 12 months.

The categories are commercial real estate loans, mortgage loans and other lending, including credit cards, small-dollar unsecured loans, automobile loans and student loans.

FIGURE 27

How important is credit risk to your bank?

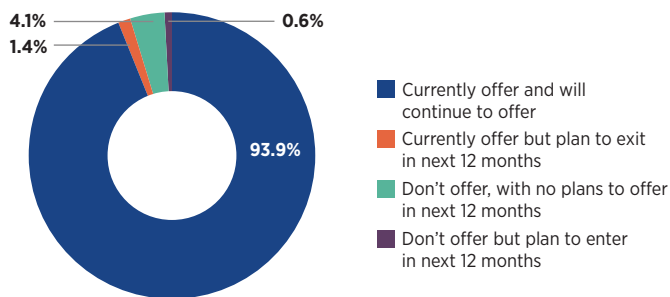


Loans are a defining characteristic of banking relationships. Not surprisingly, most bankers noted that credit risk was a very important or important factor for their banks.

COMMERCIAL REAL ESTATE LENDING

FIGURE 28

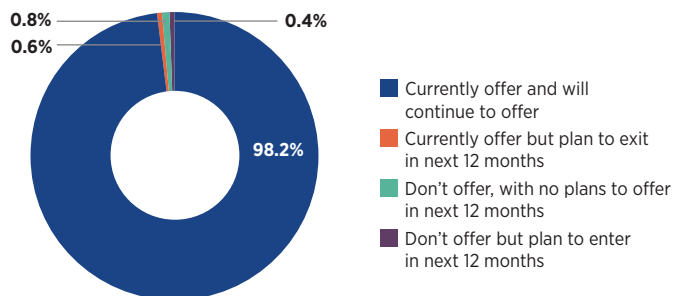
What are your intentions regarding construction loans?



Construction loans were offered, with plans for continuation, by nearly 94 percent of respondent banks, which is identical to the share reported last year. Among the small number of banks with plans to change participation in construction loans, more planned to exit than to enter this market. This is the opposite of last year, when more banks planned to enter than to exit. Most bankers attributed exit plans to contracting markets.

FIGURE 29

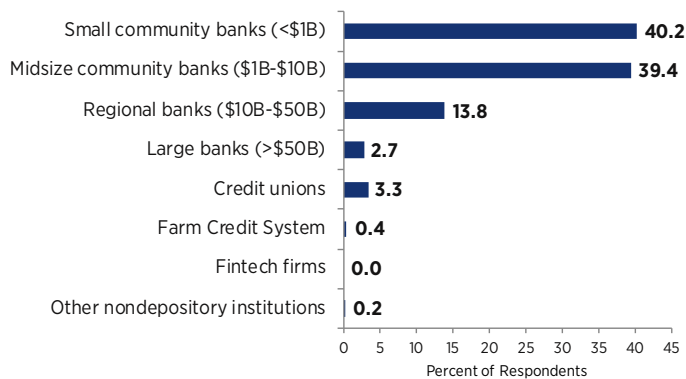
What are your intentions regarding commercial real estate (CRE) loans?



CRE loans, exclusive of construction, were offered by almost every surveyed bank, underscoring this product's role as a complement to the small business loans that tend to define many community banks.

FIGURE 30

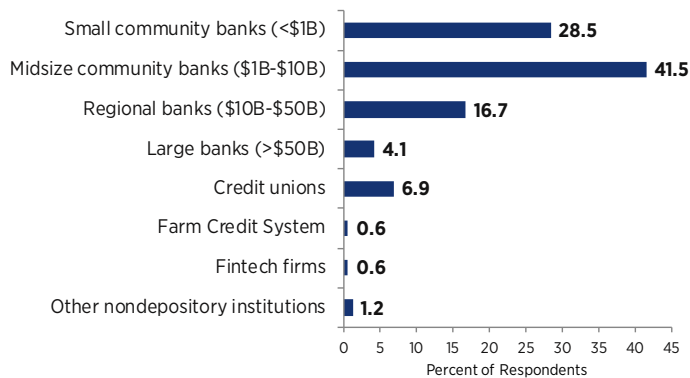
Who is your current primary competitor for CRE loans?



The widespread offering of CRE loans suggests a competitive marketplace that is internecine; in this regard, 80 percent of surveyed banks named other community banks as their greatest source of current competition.

FIGURE 31

Who is your expected future primary competitor for CRE loans?

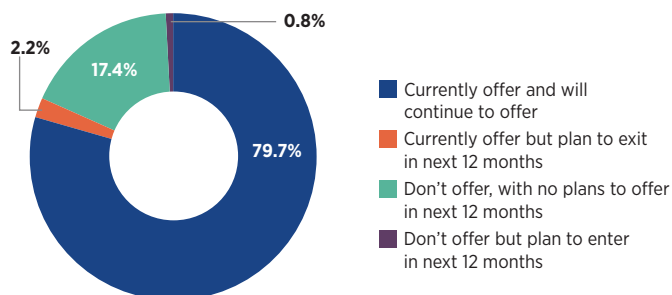


Other community banks were expected to pose less of a competitive threat in the future than they do currently (Figure 30). Bankers see this gap being filled, in part, by credit unions, whose competitive stature more than doubles to 7 percent in terms of future competition. One banker expressed concern with “credit union mission creep.”

▼ MORTGAGE LENDING

FIGURE 32

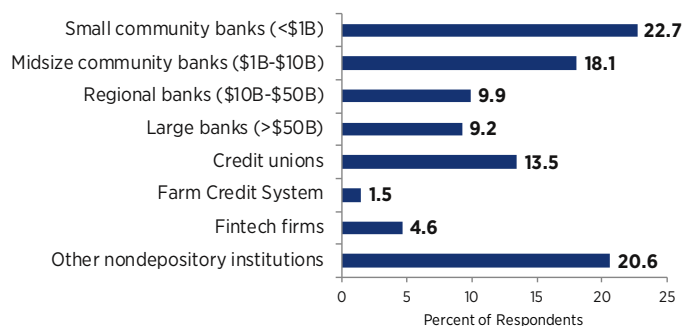
What are your intentions regarding 1-4 family, fixed-rate mortgages?



Mortgage lending was prevalent among surveyed banks, with 1-4 family, fixed-rate loans being offered, with plans for continuation, by 80 percent of respondents. This percentage was no higher than last year's, however, perhaps suggesting lackluster opportunity. “In small town America, residential mortgages are discouraging,” one banker said. “Many of the homes in our area are sold for less than \$40,000. With all the red tape to do a mortgage, we make no money, but we still do them.”

FIGURE 33

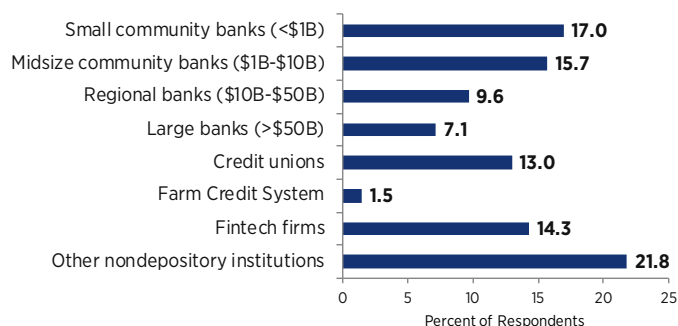
Who is your current primary competitor for mortgage loans?



Bankers described the competitive environment in mortgage lending as significantly influenced by nonbank providers. Credit unions, fintech firms and other nondepository institutions were named as the primary source of current competition by, respectively, 14 percent, 5 percent and 21 percent of bankers.

FIGURE 34

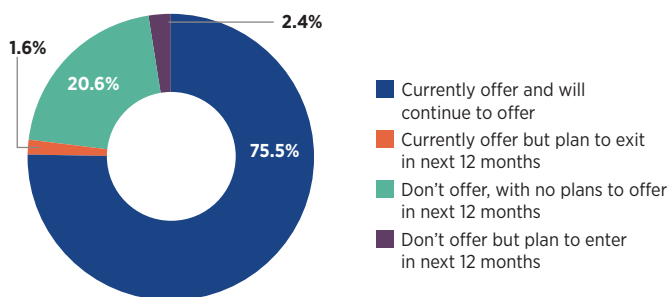
Who is your expected future primary competitor for mortgage loans?



The role of fintech in mortgage lending was expected to expand significantly. While only 5 percent of respondents currently saw these firms as competitors (Figure 33), that percentage nearly triples for future competition. "Evolving technology will crowd out community banks," one surveyed banker said.

FIGURE 35

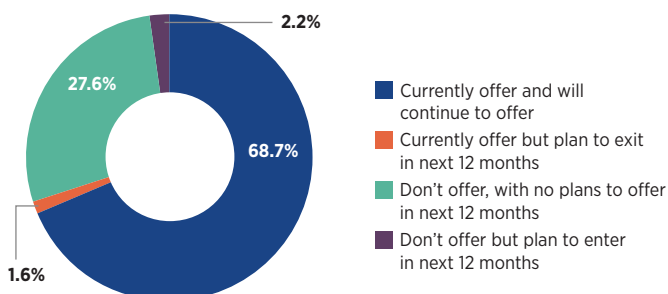
What are your intentions regarding home equity loans?



Bankers' objectives for home equity lending were very similar to those reported in last year's survey.

FIGURE 36

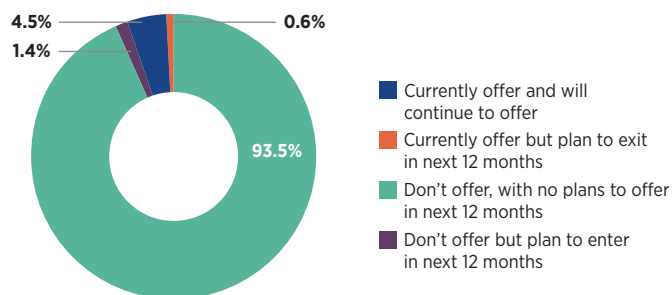
What are your intentions regarding 1-4 family, adjustable-rate mortgages?



Nearly 70 percent of bankers named adjustable-rate mortgages as ongoing offerings. This surpasses the 62 percent reported last year and is consistent with the large number of banks then that noted plans to enter this market.

FIGURE 37

What are your intentions regarding reverse mortgages?

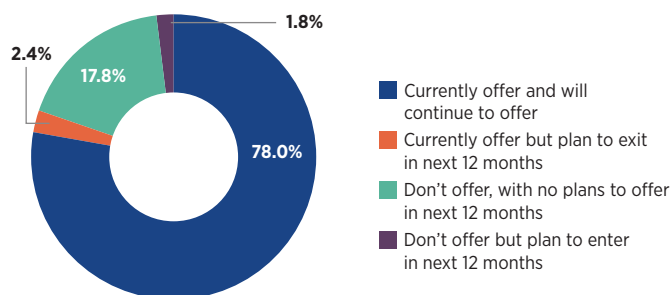


As was the case last year, few community banks were offering, or intended to offer, reverse mortgages.

OTHER LENDING

FIGURE 38

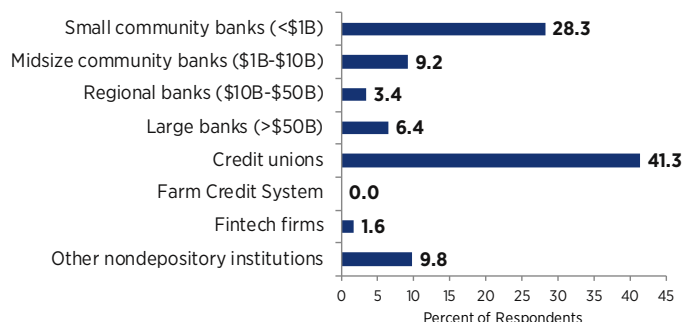
What are your intentions regarding small-dollar unsecured loans?



Small-dollar unsecured loans were offered, with plans for continuation, by 78 percent of surveyed banks. This is the same share as last year and appears to suggest a lack of interest in expansion; one surveyed banker described the “centralization and standardization of consumer loan underwriting” as a “most challenging project.”

FIGURE 39

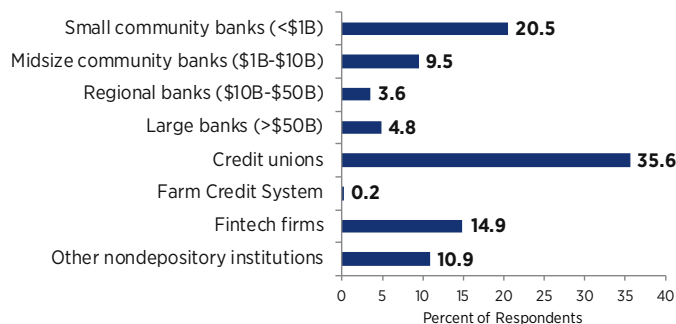
Who is your current primary competitor for consumer loans?



Bankers noted that credit unions currently dominate competition for consumer loans, followed closely by small community banks. The role played by fintech firms was viewed as modest.

FIGURE 40

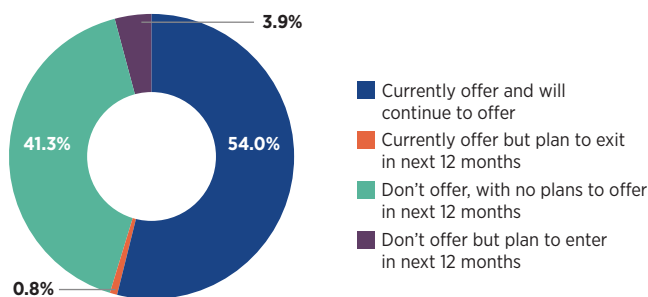
Who is your expected future primary competitor for consumer loans?



Respondents expected the high level of competition posed by credit unions and small community banks (Figure 39) to be supplanted, to some degree, by an increasing role for fintech firms.

FIGURE 41

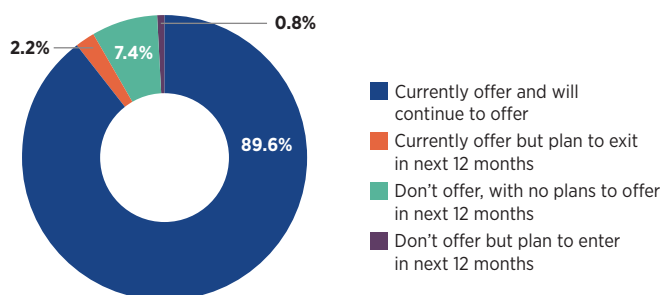
What are your intentions regarding credit cards?



Credit cards were offered, with plans for continuation, by 54 percent of banks. This share is below the 60 percent reported last year; a rebound is possible, however, given the much higher percentage of banks intending to offer credit cards than those planning to curtail them. One surveyed banker highlighted plans to “develop a better suite of consumer credit products.”

FIGURE 42

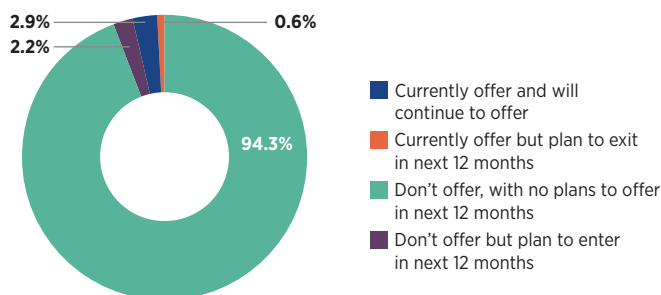
What are your intentions regarding automobile loans?



Automobile loans were named by 90 percent of banks as an ongoing offering. This percentage is slightly lower than what was reported last year, which is consistent with some responses then that pointed to planned exits due to lack of profitability.

FIGURE 43

What are your intentions regarding student loans?



Few banks reported offering student loans. This is similar to what was reported last year.

Section Summary

Surveyed bankers described lending trends and objectives that varied by product. Offerings of CRE loans were widespread at levels of penetration that were similar to those reported last year as well as to what bankers expected in the future. Mortgages and

consumer loans were offered less widely, with bankers expecting to pursue them even less so in the future. Such retrenchment may be due to an anticipated uptick in competition from fintech firms.

Nonlending Services

Trends in nonlending activities are tracked, once again, by category:

1. Services currently offered that will continue to be offered;
2. Services currently offered with plans to exit in the next 12 months;
3. Services not currently offered with no plans to offer in the next 12 months; and

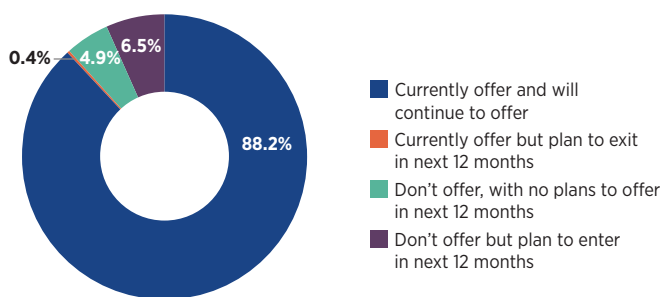
4. Services not currently offered with plans to start in the next 12 months.

Online and other digital services were characterized as opportunities by many community banks. Some bankers, however, were less enthusiastic: One respondent said that “community banking will always be firmly planted where our roots are, in both rural and urban markets, with good people doing their best to serve their communities and customers.”

▼ ONLINE SERVICES

FIGURE 44

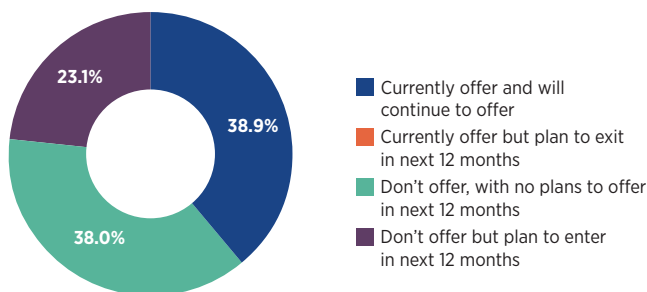
What are your intentions regarding mobile banking?



Among online services, mobile banking was offered by more than 88 percent of banks. This share is only marginally higher than last year's, suggesting that the intent then by about 7 percent of banks to introduce these services never materialized. Plans for introduction were prominent again this year. The vast majority of bankers responding affirmatively said they were motivated by a desire to meet the competition.

FIGURE 45

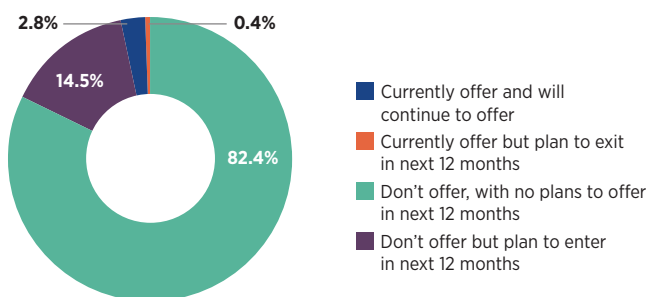
What are your intentions regarding online loan applications?



Nearly 40 percent of banks offered online loan applications on an ongoing basis. A similar percentage did not offer them and had no plans to offer them. However, 23 percent of banks that did not offer the service planned to do so in the future. This was the highest percentage of any planned introduction in this year's survey. The vast majority of these banks said that they were motivated by competitive pressure.

FIGURE 46

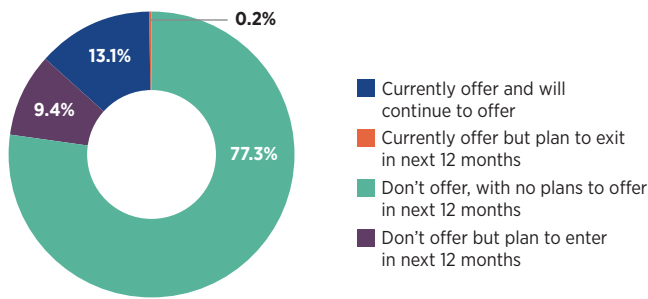
What are your intentions regarding online loan closings?



In contrast to the relatively high percentage of banks offering online loan applications (Figure 45), only a small share offered online loan closings. This sparse level of participation may increase given that more than 14 percent of bankers said they intended to add this service. “We believe the most promising opportunities are the delivery of services (applications, closings, approvals) in a more digital and automated format,” one banker said. “The challenges will be compliance and verification related to these new digital formats.”

FIGURE 47

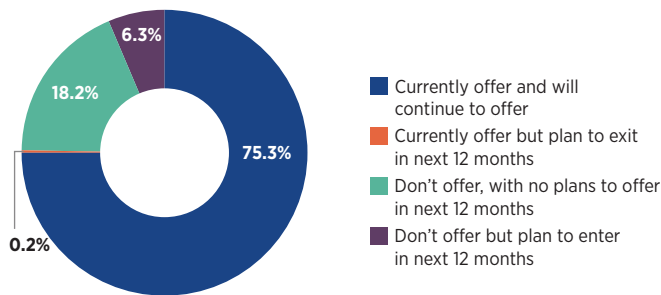
What are your intentions regarding automated loan underwriting?



Automated loan underwriting was limited as a bank offering but showed potential for growth. In this regard, 13 percent of bankers were offering the service, with 9 percent intending to offer it in the future. The latter group was motivated by profitability.

FIGURE 48

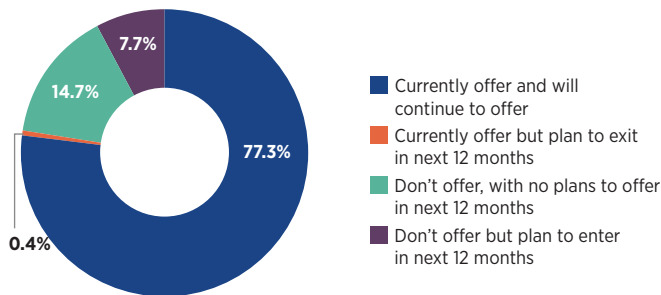
What are your intentions regarding electronic bill presentment or payment?



Electronic bill presentment or payment was offered, with plans for continuation, by 75 percent of banks, down from 89 percent reported last year. This trend may reflect the opinion of one surveyed banker who foresaw a “dramatic change coming to payments over the next decade.” Another banker worried that the increasing popularity of peer-to-peer services “means that the younger generation may not be as loyal to the traditional banking system.”

FIGURE 49

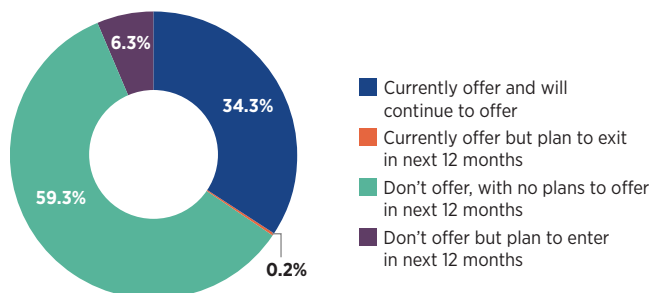
What are your intentions regarding remote deposit capture?



Remote deposit capture was named by 77 percent of bankers as an ongoing activity, the same percentage reported last year. The composition of banks may have changed, however, as last year more than 10 percent of surveyed banks planned to either enter or exit this activity. One banker noted that remote deposit capture can attract customers, particularly farmers, providing an opportunity to “penetrate other counties” despite a distant location.

FIGURE 50

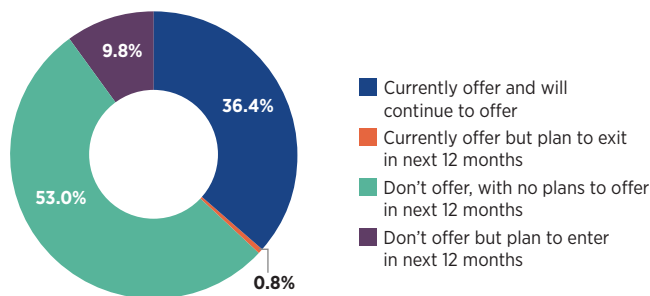
What are your intentions regarding wealth management services?



Wealth management services were offered, with plans for continuation, by 34 percent of banks, slightly lower than last year's result. However, the percentage of banks that intended to offer these services nearly doubled year over year. One surveyed banker said that automated wealth management solutions "won't be a core competency, but might be interesting, and provide for some customer stickiness in the event they wish to move their deposits elsewhere."

FIGURE 51

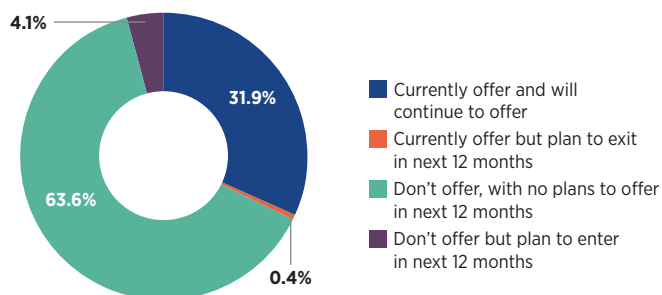
What are your intentions regarding personal financial management tools?



Personal financial management tools were named an ongoing activity by 36 percent of surveyed banks. Nearly 10 percent of banks said that they intended to add these tools in the future. One surveyed banker cited an objective of "enhancing our investment line of products."

FIGURE 52

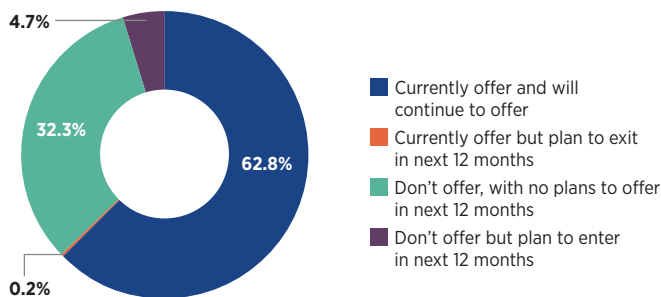
What are your intentions regarding insurance (life, accident, health)?



Insurance services were offered by 32 percent of banks. "This is one of the few nonbanking activities that banks are allowed to participate in," one surveyed banker said. "Technology is advancing where this might be a possible business line for us."

FIGURE 53

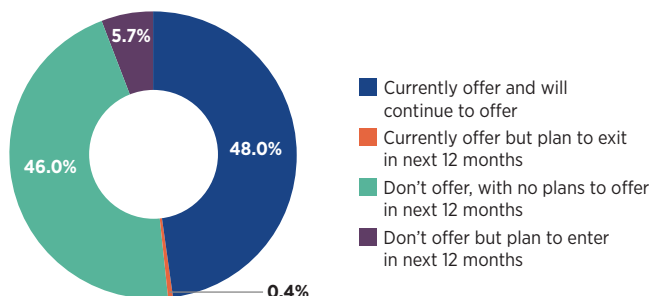
What are your intentions regarding cash management services?



Cash management services were offered, with plans for continuation, by 63 percent of surveyed banks. A desire to match the competition was the most commonly cited reason for intended expansion. One surveyed banker noted “opportunities in cash management if we can get the cost side under control.”

FIGURE 54

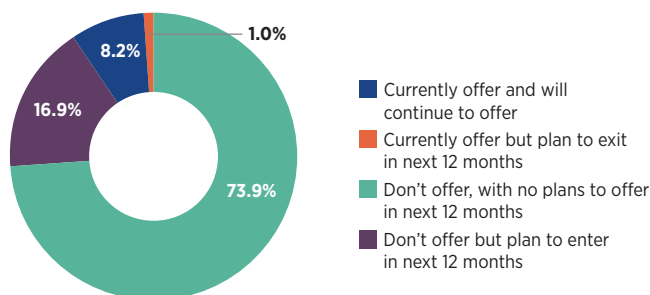
What are your intentions regarding Health Savings Accounts?



Health savings accounts were offered by 48 percent of respondent banks, roughly the same percentage reported in last year's survey.

FIGURE 55

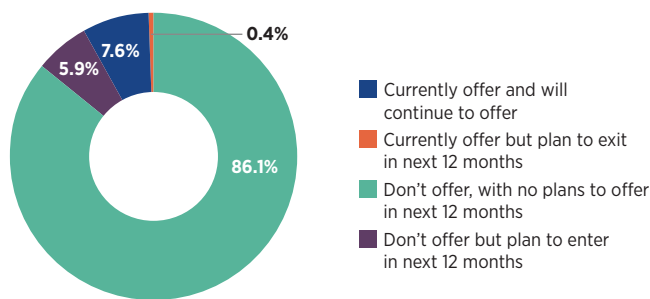
What are your intentions regarding Interactive Teller Machines (ITMs)?



A new question on this year's survey focused on interactive teller machines. ITMs did not necessarily represent a nascent service, as more than 9 percent of banks were already offering them. Still, nearly 17 percent of banks intended to introduce this service, a rate of introduction second only to online loan applications (Figure 45). Cost-cutting was a commonly cited reason for expansion; as one surveyed banker said, “[We] have a lot of remote branches. If we can integrate ITMs into them, we can manage our staffing levels better.”

FIGURE 56

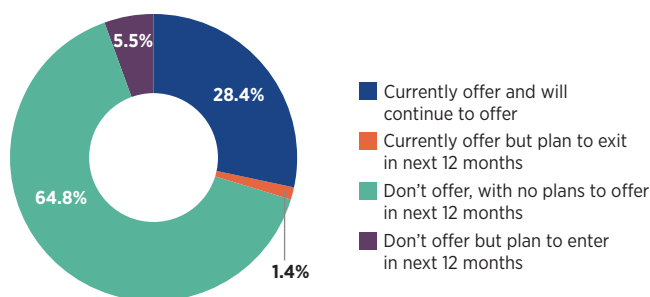
What are your intentions regarding payroll cards?



Less than 8 percent of surveyed banks currently offered payroll cards. Among the rationales cited by those that did was a desire to “serve the unbanked population.”

FIGURE 57

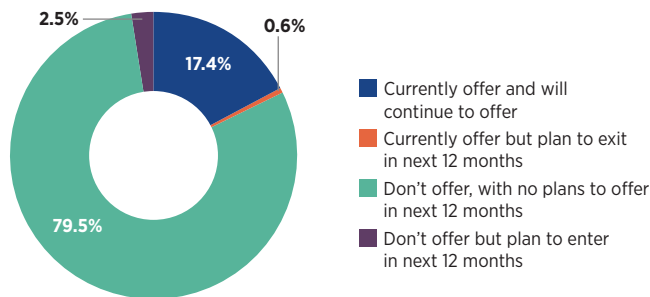
What are your intentions regarding stored value/prepaid cards?



Stored value and prepaid cards were offered, with plans for continuation, by 28 percent of banks. More banks intended to enter than to exit this activity.

FIGURE 58

What are your intentions regarding money remittance services?



Money remittance services were offered, with plans for continuation, by 17 percent of banks. Few banks expressed an interest in entering or leaving this market.

Section Summary

The rate at which surveyed banks offered nonlending services was often below levels seen in loans. But expansion appears imminent: Introductions of online loan applications, ITMs and online loan closings were planned by, respectively, 23 percent, 17 percent and 14 percent of surveyed bankers.

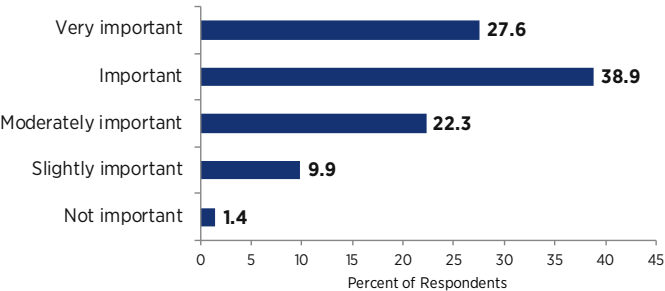
Financial Technologies

Bankers’ comments in previous surveys revealed deeply divergent attitudes about the role of technology. This year was no exception. The trade-off between benefits and costs remained a pointed struggle; one banker, in particular, was tempted by the capacity

for technology “to make it easier for customers to transact business without having to physically come to the bank” but was daunted by expenses that would be incurred with its introduction.

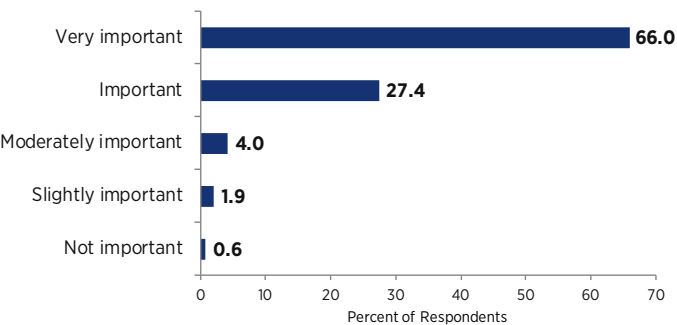
▼ IMPORTANCE OF NEW TECHNOLOGY

FIGURE 59
How important is the adoption of new or emerging technologies to meeting customer demand in your market?



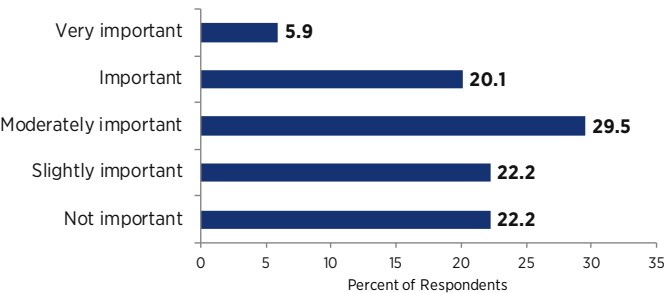
A majority of banks considered the adoption of emerging technologies to be very important or important in meeting customer demand. Still, many bankers seemed to doubt the inevitability of technological adoption; more than 10 percent said that emerging technologies were only slightly important or unimportant.

FIGURE 60
How important is cybersecurity risk to your bank?



Cyber-risk was considered to be very important or important to more than 90 percent of surveyed bankers. “Fraud and technology are the two largest challenges for our bank,” one banker said. Another respondent expressed concern with “customer information security.”

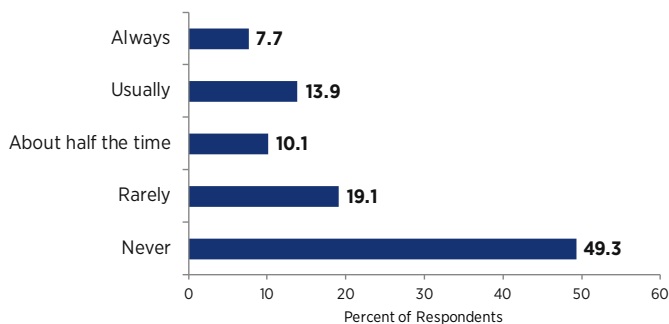
FIGURE 61
How important is being a leader in new or emerging technology adoption to meeting customer demand in your market?



Only 6 percent of surveyed bankers said that being a leader in technology was very important, while 22 percent said that it was unimportant. As one surveyed banker noted, “While we will not be first to market, we try to position our bank as a fast-adoption follower for the new technology developments gaining traction in the market.”

FIGURE 62

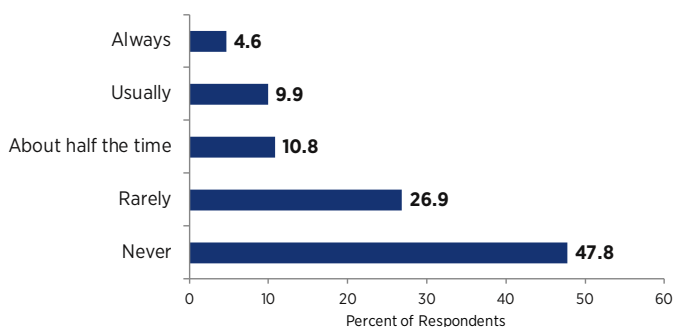
To what extent does your bank rely on in-house technology for online loans?



The majority of bankers said that they rarely or never rely on in-house technology for online loans. This was reflected in the opinion of one surveyed banker who criticized “costs of software when adding new products.”

FIGURE 63

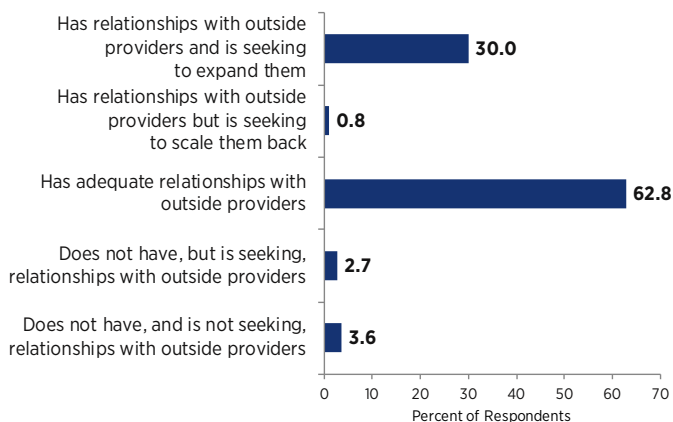
To what extent does your bank rely on in-house technology for nonlending digital products?



About 75 percent of respondents said that they rarely or never rely on in-house technology for nonlending digital products.

FIGURE 64

With respect to outside providers of digital banking products and services, our bank:



Thirty percent of banks reported intentions to expand relationships with outside providers of digital banking products and services. A larger number of respondents, nearly 63 percent, were satisfied with services already provided. Both results appear consistent with the opinion of one surveyed banker who noted that dependence on “critical vendors of core products and services [creates] opportunity to adopt better and cheaper technology.”

Section Summary

Community bankers continue to struggle with the opportunities and costs associated with technological products and services. But they are also struggling, to a much greater extent than in the past, with third-party vendors that support technology. One banker, for instance, described challenges in vendor management created

by “emerging technologies occurring outside of the traditional operating core providers.” Another said that “vendors in the bank space are very limited and exhibit monopolistic behaviors, and their contracting practices are very one-sided.”

The Tax Cuts and Jobs Act of 2017

The Tax Cuts and Jobs Act, signed into law in December 2017, lowered tax rates paid by businesses and individuals, limited some tax deductions and made other changes to tax policies. We asked community bankers several questions concerning how this act has affected or could affect lending in various categories.

IMPACTS ON LOAN DEMAND

One set of questions concerned demand for loans. Responses are presented in Figures 65 through 70.

LENDING TO DATE

FIGURE 65
So far in 2018, how has the Tax Cuts and Jobs Act affected small business loan demand?

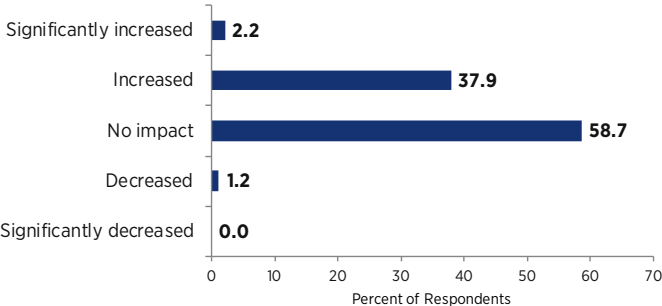


FIGURE 66
So far in 2018, how has the Tax Cuts and Jobs Act affected mortgage loan demand?

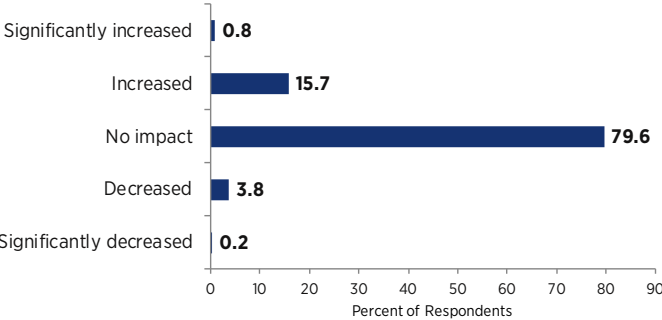
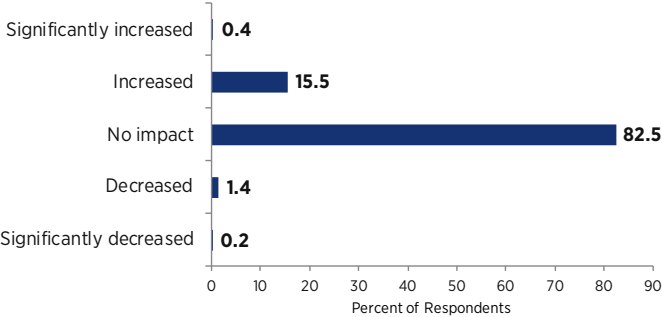


FIGURE 67
So far in 2018, how has the Tax Cuts and Jobs Act affected consumer loan demand?



FUTURE LENDING

FIGURE 68
Going forward, to what extent do you think the Tax Cuts and Jobs Act will affect small business loan demand?

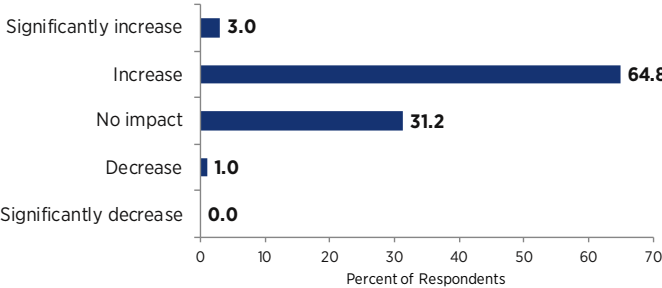


FIGURE 69
Going forward, to what extent do you think the Tax Cuts and Jobs Act will affect mortgage loan demand?

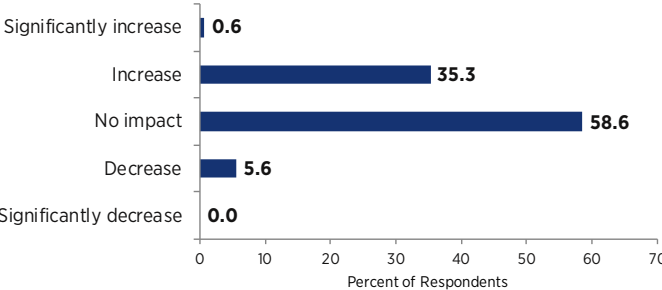
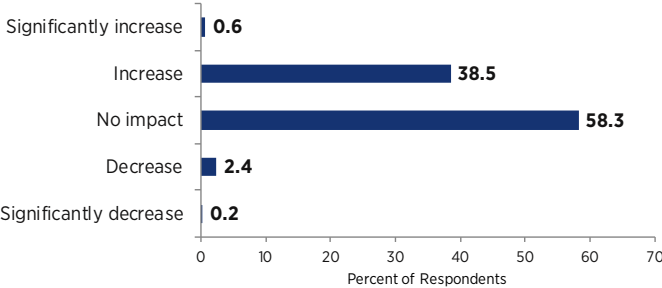


FIGURE 70
Going forward, to what extent do you think the Tax Cuts and Jobs Act will affect consumer loan demand?



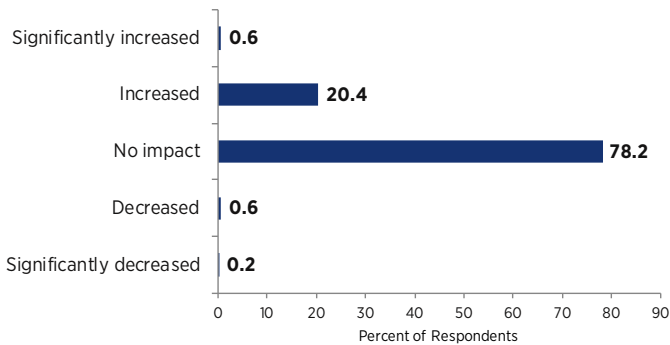
Between 16 percent and 40 percent of community bankers said that the act, at the time they took the survey, already had increased demand for various types of loans. A majority of bankers, however, said demand was unaffected (Figures 65 through 67). Bankers were more optimistic with respect to future loan demand (Figures 68 through 70).

IMPACTS ON BANKERS' WILLINGNESS TO EXTEND CREDIT

Other questions examined the willingness of banks to provide loans or acquire municipal securities.

FIGURE 71

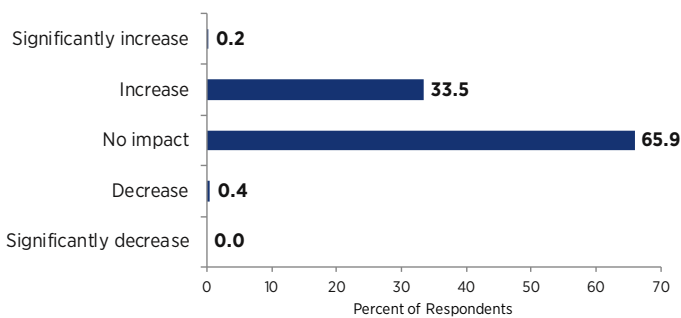
So far in 2018, how has the Tax Cuts and Jobs Act affected your willingness to supply small business, consumer and mortgage loans?



Although more than 20 percent of respondents reported greater incentives to offer loans as a result of the act, a majority of them noted no effect.

FIGURE 72

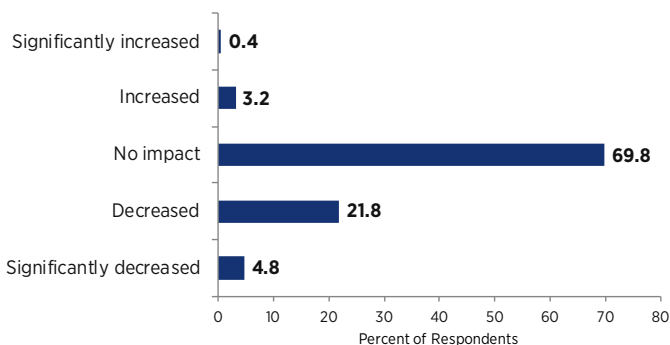
Going forward, to what extent do you think the Tax Cuts and Jobs Act will affect your willingness to supply small business, consumer and mortgage loans?



Some bankers anticipated greater lending opportunities in the future.

FIGURE 73

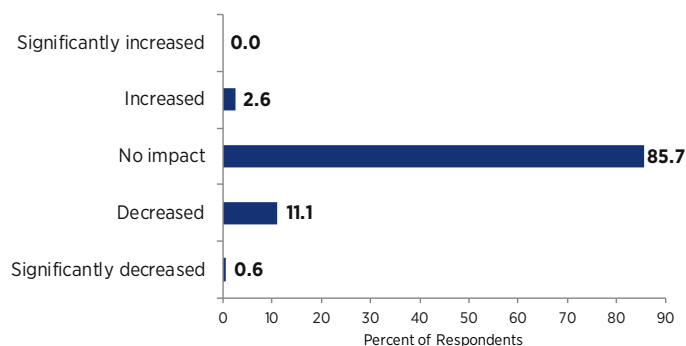
So far in 2018, how has the Tax Cuts and Jobs Act affected your willingness to purchase tax-exempt securities from local governments?



More than 25 percent of respondents said that their willingness to purchase tax-exempt municipal securities decreased or significantly decreased as a result of the act, which is consistent with limits imposed on deductions for interest income on municipal obligations.

FIGURE 74

So far in 2018, how has the Tax Cuts and Jobs Act affected your willingness to make tax-exempt loans to local governments?



About 12 percent of bankers said their willingness to make tax-exempt loans to municipalities decreased or significantly decreased with passage of the act. This suggests that the act's effects on incentives to offer loans were less than on incentives to buy securities (Figure 73).

Section Summary

Surveyed bankers said that the Tax Cuts and Jobs Act enacted last year increased the demand for loans, particularly small business loans, on both an ongoing and prospective basis. The act also increased bankers' willingness to supply loans. However, it decreased their willingness to extend credit to municipalities.

Regulatory Compliance

In last year's survey, many community bankers anticipated a turn in what they perceived to be an onslaught of new regulations imposed in the aftermath of the financial crisis. Their optimism was fueled by regulatory changes under EGRPRA, which reduced financial reporting requirements, lengthened examination cycles and waived appraisal requirements for smaller banks and holding companies. Some of these changes already had taken effect by the time a report on EGRPRA was published in the Federal

Mean compliance expenses in four of the five categories listed in Table 1 declined in 2017 relative to 2016. This may reflect an improvement in the efficiency of bankers in satisfying regulatory requirements, particularly those associated with rules that took effect in late 2015.⁴ It could also reflect rollbacks under EGRPRA. Or, it could reflect withdrawals from products with high compliance costs; in this regard, one community banker "reduced offerings to limit exposure."

Consulting and advisory services constituted the single category for which relative expenses increased. This may reflect the previously mentioned reliance of banks on external providers of technological services; recall that 30 percent of bankers said that they sought to expand relationships with these providers.

In Table 2, we apply the compliance cost percentages observed in Table 1 to publicly available data on the community banking industry to create an estimate of overall compliance costs.⁵

The estimated total dollar amount for compliance costs in 2017 under this methodology was \$4.7 billion, representing 21 percent of community bank income. This amount is lower than the \$5.4 billion reported for 2016, which represented 24 percent of 2016 community bank net income.

The decline in inferred compliance costs was pronounced in personnel expenses, which decreased to \$3.562 billion in 2017 from \$4.236 billion in 2016, or by 16 percent. By comparison, personnel expenses for the community banking industry, inclusive of compliance activities, decreased by about 2 percent during the same period after increasing in each of the three previous years. This is consistent, directionally, with trends reported in Table 2.

We acknowledge limitations in matching data on the relatively small number of banks that responded to the survey with industry aggregates. Our interpretations must be qualified accordingly.

Register on March 30, 2017. Others were planned but not yet implemented.

But data from last year's survey were deflating. Expenses for personnel, data processing, legal services, accounting and auditing, and consulting and advisory services, expressed as percentages of total within-category expenses, were higher in 2016 than in 2015. Responses to this year's survey suggest that outcomes have caught up with expectations.

TABLE 1

Compliance Costs as a Percentage of Total Expenses by Category

	2017	2016	2015	2014
Personnel (Salary and Benefits)	10.4% 7.1%	12.3% 7.7%	11.4% 7.5%	10.6% 5.8%
Data Processing	17.0% 12.3%	17.8% 11.4%	17.6% 12.9%	16.2% 10.0%
Legal	21.0% 12.7%	23.0% 14.7%	20.7% 12.8%	20.5% 10.6%
Accounting and Auditing	39.1% 31.3%	41.7% 35.1%	41.5% 35.3%	38.5% 30.6%
Consulting and Advisory	46.1% 41.7%	44.6% 39.4%	42.6% 34.3%	47.5% 40.0%

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

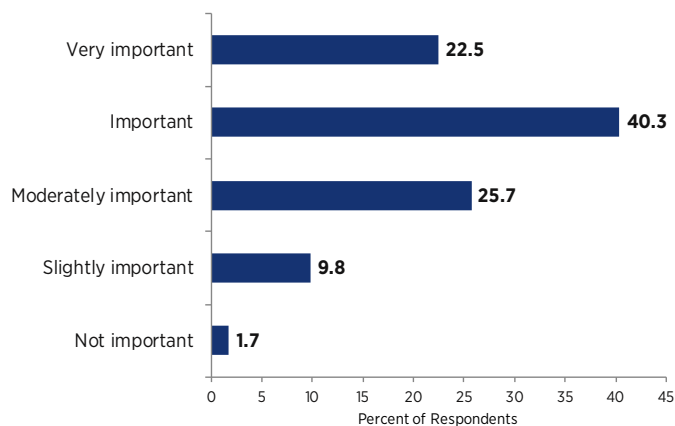
TABLE 2

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

	2017	2016	2015	2014
Personnel (Salary and Benefits)	\$3,562	\$4,236	\$3,801	\$3,350
Data Processing	\$509	\$532	\$507	\$440
Legal	\$88	\$109	\$112	\$128
Accounting and Auditing	\$184	\$199	\$223	\$198
Consulting and Advisory	\$348	\$327	\$325	\$378
Total	\$4,691	\$5,403	\$4,968	\$4,494

FIGURE 75

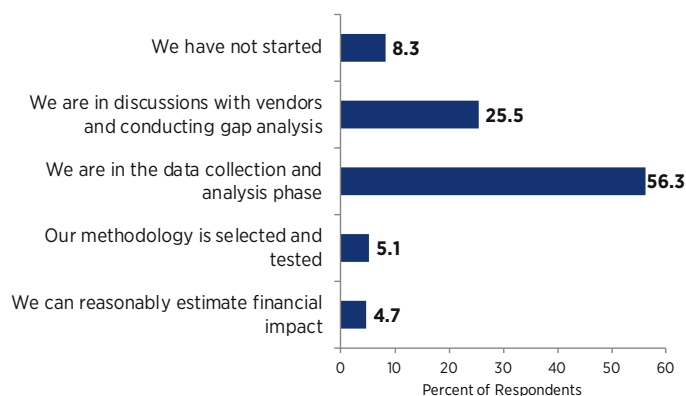
How is compliance risk tied to the Bank Secrecy Act (BSA) viewed at your bank?



Bankers characterized new rules promulgated by the Financial Crimes Enforcement Network, which require financial institutions to identify and verify the beneficial owners of legal entity customers, as “overbearing” and “undue.” BSA is a regulatory area of emphasis and therefore poses high risk.

FIGURE 76

What is the current status of your transition to the Current Expected Credit Loss (CECL) methodology?



Community bankers expressed concern that CECL, which is intended to address delays in the recognition of loan losses, will complicate collection of data on loan quality. Although this rule will not be fully implemented across banks for several years, the majority of banks surveyed were already preparing for it.

“Implementation of CECL is overly complex and far-overreaching for an institution as noncomplex as ours,” one surveyed banker said. “The burden and the cost of CECL may have an impact on an institution’s willingness to lend in the future. It is virtually impossible to administer absent highly advanced and expensive experts or systems.”

Section Summary

Our analysis of compliance costs suggests that the burden of regulation is perhaps a little less weighty today than it was previously. Some bankers noted that they were looking forward to further reductions following passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)

earlier this year. EGRRCPA, which in some ways represents an extension of reforms under EGRPRA, amended Dodd-Frank along several dimensions that affected community banks.

“Some regulatory relief is encouraging,” one surveyed banker noted. “Hopefully, it will go further.”

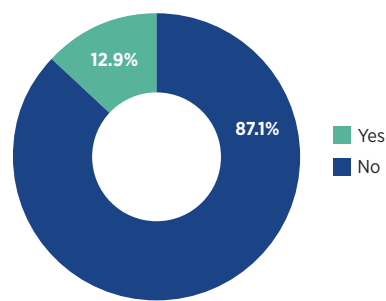
Incentives to Acquire or Be Acquired

In this section, we examine the forces that motivate banks to make, or consider, acquisition offers. Offers are predicated on bank-specific factors, as well as on factors related to the markets in which banks operate. In terms of the latter, the notion of

what constitutes a market for a community bank is increasingly challenged by technological advances that, in the opinion of one banker, “are rapidly making the idea of any geographic region somewhat outdated.”

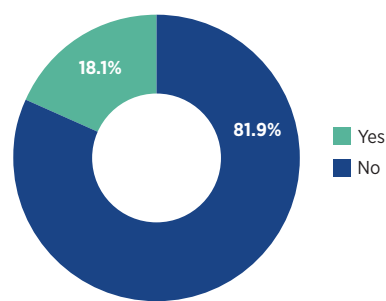
▼ ACQUISITION ACTIVITY

FIGURE 77
Have you received and seriously considered an acquisition or merger offer in the last 12 months?



About 13 percent of banks said that they had recently received and seriously considered an acquisition offer. This was slightly higher than the 11 percent reported in last year’s survey.

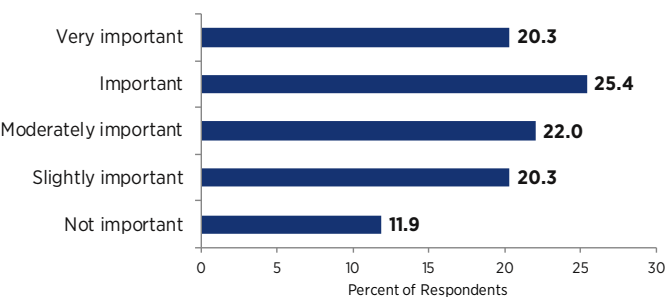
FIGURE 78
Have you made an offer to a target institution in the last 12 months?



About 18 percent of banks said that they had made an offer to acquire another institution within the past year. At times, offers are initiated by target institutions, and not all of them are consummated; one surveyed bank, for example, said that it “eventually backed away” from a request to buy a smaller bank.

▼ SUCCESSION PLANNING

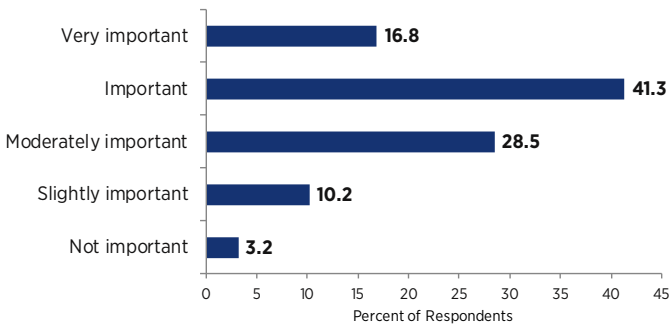
FIGURE 79
How important were succession issues in your decision to seriously consider an acquisition offer?



More than 20 percent of respondents contemplating acquisition offers viewed succession issues as very important. Less than 12 percent considered these factors unimportant.

FIGURE 80

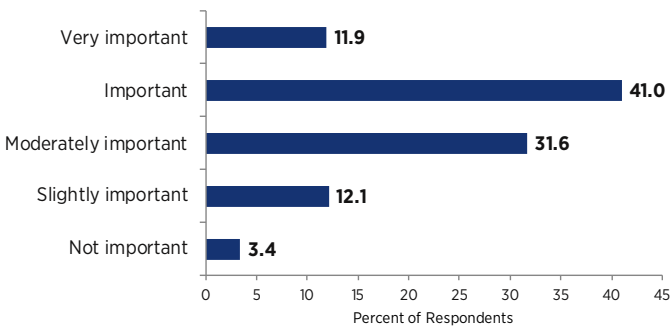
How important is management succession risk to your bank?



Risks associated with managerial succession were considered to be very important or important by a majority of survey respondents.

FIGURE 81

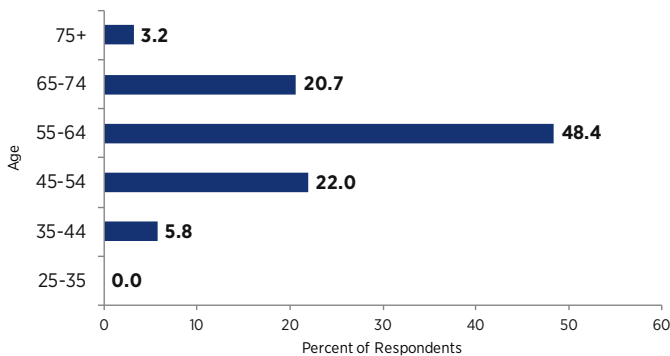
How important is board succession risk to your bank?



In addition to managerial succession (Figure 80), respondents also expressed concern, approximately equal in magnitude, with succession of board members.

FIGURE 82

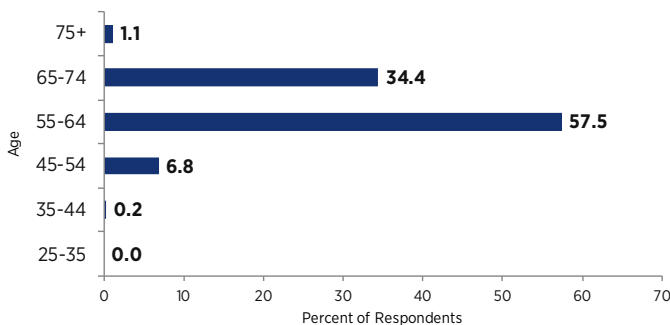
What is the current age of your CEO?



Uncertainty regarding succession and related risks may be pronounced for banks headed by aging management. Nearly a quarter of those banks in our sample had CEOs who were at least 65 years old.

FIGURE 83

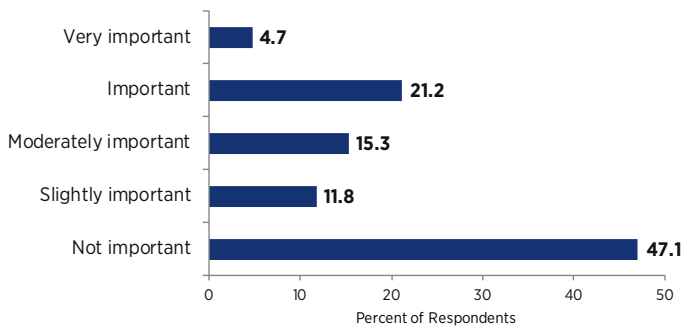
What is the median age of your board of directors?



The aging of board members also can raise succession concerns. More than 35 percent of banks had boards of directors with a median age of 65 or older.

FIGURE 84

How important were succession issues in your motivation to make an acquisition offer?

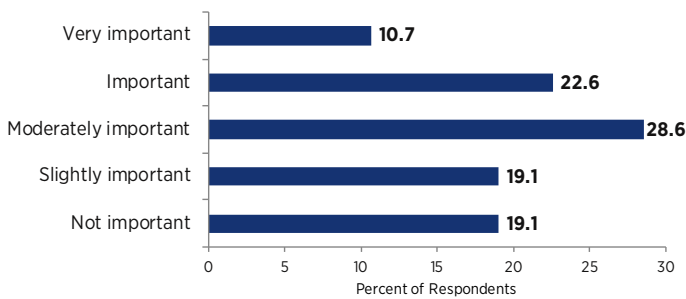


Succession issues were deemed not particularly important by the majority of banks making offers to acquire other banks.

MANAGERIAL ABILITIES

FIGURE 85

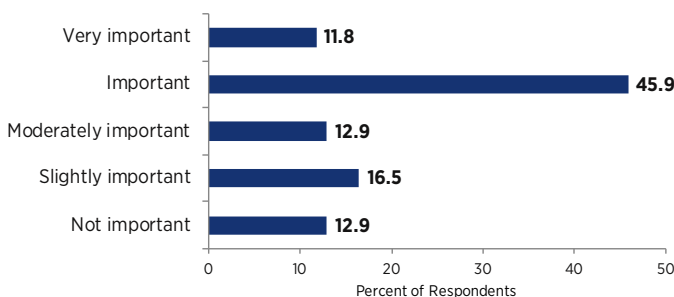
How important was the opportunity to capture the abilities of bank managers in your motivation to make an acquisition offer?



The majority of bankers said they were motivated by a desire to capture the inherent abilities of the managers at target institutions. Nearly 11 percent of them considered this to be a very important consideration in making an acquisition offer.

FIGURE 86

How important was the ability to exploit underutilized potential in your motivation to make an acquisition offer?

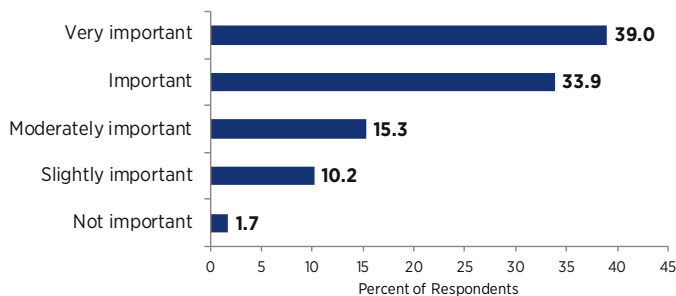


Another key motivation was the perceived inability of managers at target institutions to take advantage of opportunities available to them. A majority of bankers considered this to be a very important or important motivation in making an acquisition offer.

▼ COST EFFICIENCIES

FIGURE 87

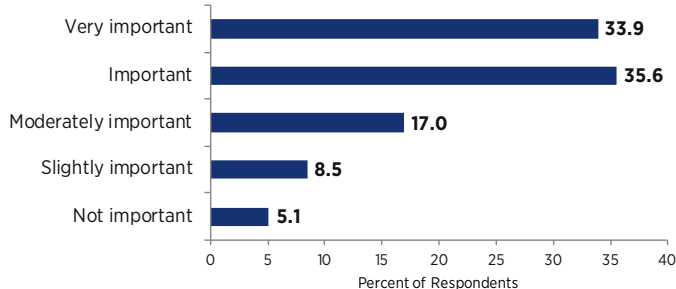
How important was the cost of regulations in your decision to seriously consider an acquisition offer?



The inability of smaller banks to satisfy regulatory requirements, often attributed to high costs, was identified as a key factor in weighing acquisition offers. This was underscored by one banker who noted that “pressure from regulatory burdens [has created] costs that have become increasingly untenable for smaller institutions.”

FIGURE 88

How important was the lack of economies of scale in your decision to seriously consider an acquisition offer?

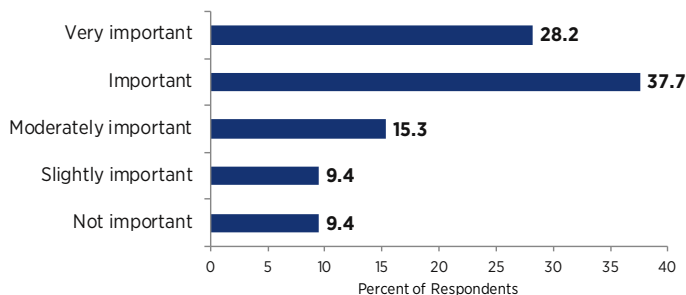


Other inefficiencies prompting bankers to consider acquisition offers were related to economies of scale—for instance, the need to invest in technology, which can be burdensome for smaller banks but necessary for them to keep pace with larger competitors. One surveyed banker said that “a bank needs to have \$1 billion in assets to afford the technology needed to be competitive.”

▼ MARKET ACCESS

FIGURE 89

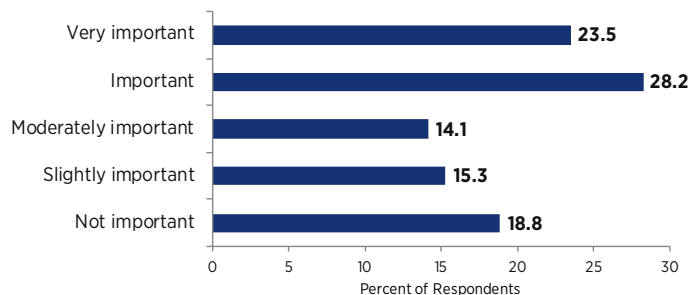
How important was the desired entry into a new market to your motivation to make an acquisition offer?



Nearly 66 percent of bankers identified expansion outside existing markets as a very important or important motive for making acquisition bids.

FIGURE 90

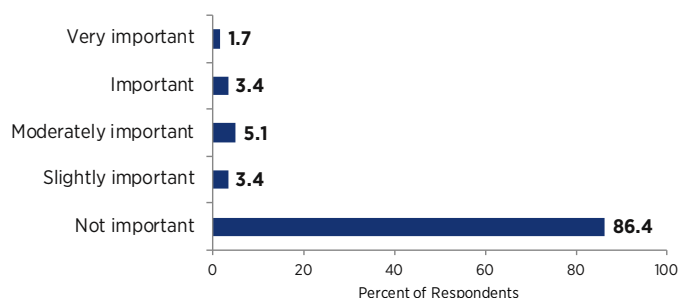
How important was expanding within an existing market to your motivation to make an acquisition offer?



Expansion within existing markets was viewed by more than half of bankers as a very important or important motive.

FIGURE 91

How important was the opportunity to start a de novo bank to your decision to seriously consider an acquisition offer?



Only a handful of new, or “de novo,” banks were started in the aftermath of the recession. Applications for new charters, however, are increasing; more new banks are now in the process of formation than were launched during the entire period of 2013 through 2017. Yet, this trend is not reflected in the rationales cited by surveyed bankers considering acquisition offers.

Section Summary

Many factors, including succession issues, drive bankers’ decisions related to acquisition activity. These factors are pronounced at smaller banks and can, at times, appear foreboding:

“More assimilation of community banks into larger institutions through mergers and acquisitions [will] lead to less competition,

less responsiveness to community needs and less responsibility to the communities that rely on community banks for their livelihood,” one banker said. Replacement of them by larger institutions “will ultimately lead to less product variety and less ability to meet the local community banking needs.”

Conclusions

Our sixth annual report on the state of the community banking industry marks a potential shift in regulatory burden, with compliance costs incurred by surveyed banks declining in 2017 after increasing in previous years.

Another, and somewhat surprising, finding concerns the divergent views expressed by bankers on opportunities created by financial technology: While the majority of surveyed bankers viewed emerging technologies as important, a significant minority also considered them irrelevant. Consistent with this, nearly the same proportion of banks offered online loan applications as those that did not.

“Everything we have looked at providing up to this point has had a cost that does not make it feasible with the number of customers in our market that want the technology,” one surveyed banker said. This view was in contrast to that of another banker who felt compelled to offer costly new services in order “to stay competitive.”

Another divergence, this one marked by time instead of by banker, concerned the competitive threat to community banking posed by the fintech industry. Fintech was named a primary competitor for small business loans, consumer loans, mortgage loans and deposits by the same, and relatively small, percentages of bankers as last year. However, these percentages grow dramatically with respect to future competition—just as they did last year. The fintech future that many bankers fear has not yet arrived and may be slower to arrive than some anticipated.

But it appears to be coming:

“The future of consumer banking seems to be as a participant in the ecosystem of lifestyle technological solutions rather than as a standalone banking relationship,” one banker said. “It’s hard to imagine what exactly that will look like and how it will change the banking business model.”

Endnotes:

- 1 Inferred costs were calculated by applying percentages identified in the survey to industrywide data obtained from financial reports (“Call Reports”) published by the Federal Financial Institutions Examination Council (FFIEC). See the section on regulatory compliance, pp. 33-39, in this publication.
- 2 In all figures and tables, percentages represent the number of responses in a given category relative to all banks that answered those particular questions.
- 3 Figures are derived from the FDIC Quarterly Banking Profile and the Farm Credit System.
- 4 These include Bank Secrecy Act and anti-money laundering regulations, as well as mortgage regulations associated with the Truth in Lending Act and Real Estate Settlement Procedures Act Integrated Disclosure Rule (TRID).
- 5 As previously indicated, the source of all data on the banking industry is the FFIEC.



Five Questions for Five Bankers

Five Questions for Five Bankers

A Summary of the Responses Given by State

To augment the 2018 National Survey of community banks that was administered in advance of this year's *Community Banking in the 21st Century* research and policy conference, interviews were conducted with community bankers in select states. The objective of the "Five Questions for Five Bankers" interviews was to create dialogue and put the national survey results into context at the state level. The questions were generally posed to five community bankers selected by 29 state bank commissioners in 28 states. Responses are listed alphabetically in this appendix.

The questions addressed trends in industry consolidation, supervision and regulation, differentiation among banks making small business loans, the threat of technological "disruption," and managing cyber-risk.

Following are the five questions that state commissioners asked all participating bankers:

1. The trend of industry consolidation, much of it involving community banks, has naturally drawn the attention of the industry and policymakers to the viability of the community bank business model. How do you envision the community bank business model evolving or changing over the next 10 years?
2. In an effort to tailor supervisory processes and regulations to the size, risk profile and business model of banking firms, what are some suggestions on how things can be done differently in the supervisory (examination) process for your bank? How could these suggestions help improve the identification and monitoring of your bank's risks?
3. Small business lending has long been a major strength of community banks. How do you differentiate yourself when making small business loans in your market?
4. There is no lack of rhetoric around the "disruption of the banking industry." The way consumers and businesses bank is continuing to change. Do you consider changes or innovations in banking technology as an opportunity or threat for your institution? How are you embracing technological advances?
5. Financial services executives are already familiar with the impact that cyber threats have had on their industry. What practices or approaches are being implemented at your bank to manage those risks?

Responses are summarized and presented in five major areas: the future of the community bank business model; tailoring regulation and supervision to the size, risk and business model of banking firms; small business lending; embracing technological advances in banking; and cyber threats. These responses provide context for the data gathered through the survey and highlight some of the different challenges faced by community banks in different states.



Arkansas

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Arkansas bankers believe community banks remain viable as they lean on their strong customer relationships and proven customer loyalty to gain an edge over their much larger, nationally chartered counterparts. They did, however, identify several threats to community banking, namely increasing cybersecurity and compliance costs. These costs play a large role in the lack of de novo activity in Arkansas.

Bankers reiterated a concern over demographic shifts that impact bank succession and related issues regarding bank ownership, board membership and management structure. They also noted the threat posed by credit unions as they continue their rapid expansion into rural America.

Tailoring bank regulation and supervision

Bankers would like to see expanded community banking regulatory relief, as they feel overburdened with the Bank Secrecy Act and fair-lending reviews. They do, however, commend collaborations of state and federal agencies on examinations. They said that the balance between on- and off-site examinations is mitigating the impact of examinations on bank operations and personnel.

Bankers would like regulators to improve their utilization and development of technology to provide an opportunity to share data more simply. In addition, bankers would like regulators to maintain continuity with examiners by bank and region. They also requested more guidance on how to keep up with technological trends and what options may be available to best achieve successful compliance results.

Small business lending

Community bankers have a unique perspective on local businesses and a wealth of knowledge on different business types from years of small business lending in their communities. Their enthusiasm for their work and ability to serve as trusted advisers for their borrowers are strengths. Community bankers truly like to engage with small, local businesses.

While franchises and large companies with out-of-market funding are cropping up in Arkansas, bankers have not noticed a decline in Small Business Administration (SBA) lending. However, they are concerned that SBA lending is an area where fintech groups might begin to encroach.

Bankers cited fintech's ability to provide quick business analytics. They said they will evaluate partnering with fintech firms in order to further defend their small-business lending programs.

Embracing technological advances in banking

While fintech disruption and innovation are seen as current threats, Arkansas bankers see opportunities for the future. Some banks that process data in-house are looking to fintech for cheaper alternatives. Bankers noted that with the vast quantities of data that fintech companies possess, regulatory burden will certainly follow.

Cyber threats

Cybersecurity has major financial implications for community banks and weighs heavily on their relationships with consumers. Cyber liability insurance is becoming common, and innovative security solutions have provided an additional layer of security for banks. Various services exist in which a bank card can be turned on or off. Text alerts also can provide consumers a level of protection that was not available before.

Arkansas bankers said their biggest threat is consumer vulnerability through phishing. Strong firewalls, network security and preventative training in place at banks are insufficient if consumer accounts are compromised by the consumer's own negligence; even then, the bank is consistently blamed. Strong contractual language limits bank liability, but the reputational risk is high. Use of third-party vendors for security also carries some risk, but it seems necessary given the high cost of bringing some of these services in-house.



Connecticut

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Bankers in Connecticut believe that the community bank business model, which traditionally was based on branch networks, has adapted to the differing needs of customers via improved technology. As customer expectations change, community banks are being compared with larger banking entities.

In addition to using newer digital services through Amazon, Google and Apple for banking or nonbanking needs, customers use Quicken Loans' Rocket Mortgage. Community banks are beginning to educate their employees in banking-related digital features in order to better expand consumer services. Bankers believe that their ability to work with fintech will give them the relevance needed to remain viable.

Amid continuing consolidation, community banks are facing higher costs to keep up with larger banks. Because of these costs, community banks need to "scale up." Bankers see themselves as most relevant to small-dollar borrowers since larger banks do not operate as often in that segment of the market. Community banks with total assets of less than \$1 billion appeal to a different consumer base.

Tailoring bank regulation and supervision

Bankers asked that regulators endorse capital acquisitions by mutual banks using capital market certificates, which would provide them with an additional resource. Bankers want the de novo bank period to be set to five years and restrictions on their brokered deposits to be adjusted. This would help smaller banks that have few branches and tend to struggle with collecting core deposits.

In terms of improving the examination process, bankers suggested that chief executive officers of banks complete self-assessments ahead of exams. This

would provide a baseline for the pre-examination interviews and lead to a better risk focus by examiners. For banks with high ratings, examiners could review both internal and external paperwork from auditors off-site, limiting the time and amount of people needed on-site.

Small business lending

Connecticut's bankers are focused on differentiating themselves in small business lending by promoting and enhancing their personal relationships with customers. Listening to customers, serving as trusted advisers and being easily accessible are ways in which bankers said they stand out among the competition. They emphasize a consultative approach versus a hard-sell approach in small business lending.

Bankers said that larger regional banks often have ignored small loans between \$100,000 and \$500,000, which community banks commonly provide. Another way to stand out is to deliver a full range of small-business services from a good team of staff that can handle all customer needs.

Embracing technological advances in banking

Some of the disruption created by technology has created an opportunity for community banks to expand into markets that they might not have reached otherwise. Bankers said that a comprehensive digital banking strategy is key to providing a stable digital experience for customers. With more technology entering the banking world, customers have high expectations and a desire for one-stop shopping, similar to the ease of services provided by companies like Amazon, Google and Apple.

One banker talked about creating a new position of chief digital officer that would

focus on investigating new technologies, software and programming for new systems. Bankers believe that embracing fintech is the best approach since customers are demanding it.

Cyber threats

Bankers said they are embracing prevention, detection and response modeling as ways to counter cyber threats. Bankers are focusing on staff training, anti-virus/malware packages, strong firewalls and strong detection systems. They are creating and ensuring proper response plans to potential cyberattacks, which, in some cases, include media response plans and updates to customers, regulators and the public.



Future of the community bank business model

Although Georgia bankers view the community bank business model as viable, they are aware of its challenges. One challenge, bankers said, is returning value to shareholders. As community banks grow, they need to focus on retaining earnings to preserve capital and meet regulatory capital ratios. This hampers their ability to pay dividends to investors.

Illiquidity in a community bank's stock also hinders the ability to return value to shareholders. This has been a contributing factor in post-recession merger activity in the state.

A lack of experienced bankers also creates challenges in creating new banks, as many banking professionals focus on developing specific professional disciplines. In addition, the training programs of large banks fall short in terms of developing well-rounded bankers who can operate community banks.

Another industry challenge is a shortage of experienced commercial lenders. Community banks cannot rely solely on a large concentration of commercial real estate loans to support earnings and growth as they did in the past, bankers said. A shortage of commercial lenders hampers growth prospects for community banks.

Tailoring bank regulation and supervision

Community bankers generally were satisfied with efforts taken by regulators to streamline the overall examination process. A surge in off-site work has alleviated some issues, they said. Bankers highly value on-site discussions with examiners.

A transition to more risk-focused examinations has allowed examiners and bankers to spend more time addressing higher-level matters concerning the measurement, identification and monitoring of

risks involving information technology and cybersecurity. However, the same approach did not necessarily hold true for consumer compliance examinations, as bankers noted unnecessary requests and processes related to them.

Bankers also expressed some frustration with the higher costs and allocations of personnel needed to comply with the Community Reinvestment Act (CRA), the Bank Secrecy Act (BSA) and Anti-Money Laundering (AML) regulations. While they recognize the importance of these regulations and programs, the compliance examination process needs to be modernized and made more transparent. Bankers also indicated that regular feedback from regulators or law enforcement agencies on the usefulness of Suspicious Activity Reports would be welcome, as they spend a great deal of time and effort identifying and reporting suspicious financial activities.

Small business lending

Community bankers still feel that they have a competitive advantage in meeting the needs of small businesses within their communities. That competitive advantage was said to be rooted in differentiating themselves from their larger-bank counterparts. Most of the large or regional banks offer lending terms that are tied to strict credit-granting parameters, bankers said, and their credit approval processes are out of touch with the relationship lending approach backed by community banks.

Bankers also noted that the smaller loan sizes requested by many small businesses are often disregarded by larger banks given the disproportionate costs of origination. Community bankers do worry, however, that large banks will eventually focus more on small business lending. They also are concerned about credit unions increasing their presence in this area.

Embracing technological advances in banking

Community bankers see technology more as an opportunity than as a threat. They said that a dependence on large core-service providers disadvantages community bankers in more urban areas by limiting their service or product offerings in comparison with their larger counterparts'. However, bankers in more rural areas felt that new technologies offered by their core-service providers were being deployed in a reasonable time frame to meet their customers' needs.

Bankers across the state recognize the advantage of having a core processor develop new products, insofar as the cost is spread out among various institutions. Bankers also embrace the use of technologies that allow them to automate processes within their banks, which, in turn, allows them to operate with a smaller dedicated staff and lower costs.

Cyber threats

The potentially catastrophic impact of a cybersecurity breach is a topmost risk for community bankers. Bankers have observed a cultural shift in which cybersecurity is monitored, tested and debated continuously in training sessions. Bankers recognize that individuals are the most vulnerable. They regularly urge bank staff and customers to recognize suspicious emails or solicitations requesting personally identifiable information.

Bankers have taken significant steps to strengthen their internal information security systems, while also restricting internet access for employees and prohibiting the ability to use external thumb drives on bank-owned computers. Community banks have also enlisted the help of security vendors to assist with 24/7 monitoring.



Hawaii

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Hawaii bankers generally do not believe that the community banking model will undergo significant changes over the next 10 years. There will be more mobile banking activity, they said, but customers in the state are expected to continue using branch networks.

Some banks are opting to move away from traditional banking, while others are continuing to support the traditional brick-and-mortar banking business model. Bankers do see ongoing consolidation among credit unions, which they said will lead to larger institutions that ultimately will compete more directly with banks for residential and commercial loans and deposits.

Tailoring bank regulation and supervision

Some bankers said that their institutions have benefitted from the extension of the exam cycle to 18 months. Bankers also support legislative efforts to better tailor regulations for community banks. These efforts include the proposed exemptions from expanded mortgage reporting requirements. Hawaii bankers also noted that Call Reports are adequate for monitoring risks within their banking institutions.

Small business lending

While all of the interviewed banks were participating in small business lending to some degree, some were focusing on a specific lending niche. Some bankers were enthused to have been recognized by the Small Business Administration as a leader in small business lending within their markets. One bank focuses primarily on small, ethnic-based businesses and entrepreneurs, another on women-owned businesses, and others on commercial real estate and multifamily units. Bankers agree that successful small-business lending programs focus on building and maintaining solid relationships within the communities served.

Embracing technological advances in banking

Bankers noted that when it comes to integrating with third-party applications and their ability to offer innovative solutions, core-system vendors are an impediment. Some bankers said they are simply too small and lack the scale to integrate new technologies.

Working and partnering with new fintech entrants also can pose challenges and risks. One bank mentioned an unpleasant experience with a start-up fintech company that facilitated online loan applications. The fintech company could not deliver in a timely manner, and when its system was finally installed, it presented numerous glitches.

Cyber threats

Banks are spending an increasing amount of time and resources on information security and cybersecurity preparedness. Bankers in the state recognize that their information is a target for cyber criminals, and they are even more concerned about their customers who are not versed in digital security matters. Bankers have encouraged state officials to offer more resources to the general public and to the Hawaii Chamber of Commerce and Retail Merchants of Hawaii regarding cyber threats and cybersecurity.



Future of the community bank business model

Idaho bankers believe that the traditional community bank business model will continue to evolve over the next 10 years. While consolidation will continue, they said that community banks will remain very relevant, with “local banks supporting local communities.” One Idaho banker reflected that while “there will be a place for well-run, disciplined community banks going forward, consolidation will continue to reduce the number of smaller banks unless there is a real change that addresses the structural competitive headwinds we face.”

A continued driver of consolidation is the aging of directorates and senior management, particularly when combined with a lack of experienced bankers in the job market to replace them. One banker observed that aging factors, coupled with recent higher bank valuations, means that more banks will be entertaining acquisition offers.

Niche-focused banks were a recurrent theme among bankers, who referred to them as “banks of the future.” Community banks will need to continue to evolve within specialty or niche areas that are not typically well-served by other financial institutions. This will allow them to differentiate themselves in the marketplace and be better positioned for the future. Bankers also recognize the importance of technology in community banking and acknowledged the continued importance of the relationship-based business model. As one banker said, “Face-to-face interactions won’t disappear for business lending.”

Tailoring bank regulation and supervision

Idaho bankers stated that the overall examination process works well. Examinations are essentially an opportunity for banks to develop a regulatory perspective and make corrective changes before smaller-scale issues become larger or more systemic. Bankers also recognize that they and the examiners have the same goal: for their banks to be in safe and sound condition.

A general theme concerning tailored supervision centered on improving communication. Bankers acknowledged a preference for more proactive communication from examiners before, during and after a bank examination. For example, they said that more specific communication on supervisory expectations for complying with new regulations would be greatly beneficial. By providing more precise expectations upfront, the vagueness around proper implementation of controls, procedures and practices needed to comply would be diminished.

One banker noted that compliance examinations could be more consultative if based on the premise that banks are trying to do the right thing for their customers and their banks. Earlier issuance of pre-examination requests was another area cited for improvement. Bankers also noted that conducting off-site reviews of examination documentation to the greatest extent possible would help alleviate the burden on community banks and facilitate more targeted examinations.

Small business lending

Idaho bankers articulated the importance of understanding and serving the unique needs of the customers and businesses within their communities. For some bankers, most of the small-business lending proposals they receive are referrals from their existing customer bases. Banks can differentiate themselves from local competitors by working with small businesses in formulating appropriate loan structures, repayment terms and collateral coverage.

In addition, banks were said to be working with small businesses, in coordination with their accountants or financial advisers, to help identify and analyze financial trends and evolving business needs. This was seen as a valuable, consultative approach to community business banking. One bank holds seminars for small businesses on relevant topics such as 401(k) retirement plans, cybersecurity and management succession. This particular bank has also worked with a third-party vendor to develop proprietary software that will improve the small-business customer experience.

Embracing technological advances in banking

Idaho bankers consider innovations in banking technology to be both an opportunity and a threat. Bankers acknowledged that advances in technology will continue at a greater pace going forward. Most agreed that they must do a better job of integrating technology into their bank operations and will continue to leverage technology in lieu of branching. Most do not foresee partnerships with fintech companies as part of their business models.

Idaho *continued*

One banker stated that failing to adapt to the changes and innovations of banking technology is a big strategic risk. Another stated that technology is “absolutely an opportunity” because it allows his bank to reach its customers through electronic delivery channels and enhances the bank’s product offerings. Bankers have embraced technological advances in multiple ways and are continuing to make investments in technology and enhancing cybersecurity.

Banks need to stay focused on personal relationships while augmenting the use of technology, bankers said. Technology, by itself, cannot replace personal face-to-face service. One bank has been consistently upgrading its customer-facing technology, including updating its internet banking system, expanding its mobile banking platform, adding instant-issue debit cards, converting its credit card processing platform and even adding a loan processing system. Bankers spoke of the critical need for chief executive officers and senior management to become more versed in technology so that they can understand the risks facing their institutions. This could improve communication with chief information officers and other technology staff.

Cyber threats

Bankers described a need for better engagement by bank leadership, including the board of directors, in making technological decisions on an ongoing basis. A common concern is that the continued integration of technology will increase cyber threats and that cybersecurity will be even more critical in the future. Several bankers stated that they have taken it upon themselves to become better educated in information technology and cyber threats so that they can better understand the risks to their banks.

A central part of managing cyber threats is oversight by bank boards and senior management. Banks can better position themselves in managing cyber-risk by leveraging their internal risk assessments and by enhancing or revisiting their strategic planning activities. Some practices that bankers have taken to address cyber threats include upgrading firewalls, implementing automatic patches, penetration testing, and implementing extensive training for staff members and bank directors.



Future of the community bank business model

Community bankers in Illinois anticipate that consolidation will continue and that the number of smaller community banks will be reduced. Some bankers attribute foreseen consolidation of banks under \$1 billion in total assets to geographic expansion, funding opportunities, asset or fee generation, and an ability to gain additional efficiencies. These bankers also see the potential for larger merger deals to increase over time.

Some bankers expect that the institutions with less than \$1 billion in assets that survive consolidation will be those with committed ownership structures and a commitment to serving their communities. One banker from the Chicago area said that his institution demonstrates its commitment to the local community and customers by investing heavily in technology and people, which, in turn, will enable his bank to compete with the larger banks in the area.

Banks in smaller markets continue to face competitive challenges from online lenders that are competing for business in markets that were traditionally only served by community banks. Another challenge noted by bankers in rural markets was the amount of resources necessary to keep abreast of regulatory changes and expectations. Attracting younger workers to a community bank business model was cited as particularly challenging.

Tailoring bank regulation and supervision

A common theme expressed by bankers concerned collaboration and communication between regulators and bankers before and during an examination. For example, more structured coordination on communicating bank-identified risks to the exam team(s) before a scheduled exam could potentially reduce on-site examination resources and, in turn, reduce regulatory burden. For larger institutions, some bankers suggested that examiners rely more on bank-developed tools, external loan reviews and enterprise risk management programs to help achieve examination objectives.

One banker said that regulators should provide more explicit guidance on the roles and responsibilities of the board and management during the supervisory process. For example, examination reports or conclusions should be more explicit as to who (board or senior management) needs to address issues identified during an examination event.

Small business lending

Bankers associated with institutions with more than \$1 billion in assets focus on a full suite of products and services beyond lending. These bankers said they continuously reevaluate their underwriting processes and/or automation practices to proportionately accelerate the decision-making process, while, at the same time, fully evaluating and managing credit risk.

Some bankers emphasized their expertise in lending under the Small Business Administration. Other bankers highlighted the value of tailored financial solutions and a commitment to their communities. They

said that taking the time to understand the unique challenges faced by many small businesses goes a long way.

Embracing technological advances in banking

Bankers generally view innovations in banking technology as an opportunity. These innovations, bankers said, are changing customers' product needs and what customers expect from their banks. A challenge within the realm of technology implementation and banking relates to ensuring that appropriate risk management strategies are in place when, for example, new products or services are launched.

Some bankers said they are exploring new ways to simplify and expand their payment processing platforms. Smaller community banks stated that technology offers them the ability to serve new customers and, more importantly, retain their younger customer base.

Cyber threats

Bankers recognize the importance and need for ongoing coordination with the industry, law enforcement and regulators in exercising crisis management response plans to cyber threats. Bankers said they have applied high-level approaches to managing risks in this area, including third-party penetration testing, external and social engineering testing, various tools to monitor suspected activity, employee security awareness testing and vendor due-diligence processes. Bankers also noted that cyber insurance premiums have increased substantially over the past year.



Indiana

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Indiana bankers believe the community bank business model remains sound and relevant. Although they must be cognizant of the changing financial services environment, they also believe that they need to continue focusing on customer relationships in order to ensure that their business models remain viable. Personal touch and individual knowledge, they said, are the backbone of community banks. Customers still desire such relationships.

A consultative approach was said to help differentiate community banks from their competitors. If banks stay focused on the unique needs of their customers, they provide greater value to businesses and individuals alike. Bankers also emphasized the importance of finding a niche within their respective markets. Finding ways to utilize and leverage technology, where it makes sense, also can help ensure that community banks remain a primary source of financial services. Through the implementation of new technology, bankers said they have been able to attract more sources of funding and better leverage relationships with their clients.

Tailoring bank regulation and supervision

Bankers expressed the need for a more common-sense approach to regulation, particularly in the compliance area. They said policymakers should continue to better tailor regulations to the risk or operational profile of each bank as opposed to taking a one-size-fits-all approach. Tiered regulation would be beneficial in some cases, they said, adding that modernization of compliance regulations was overdue.

Bankers said they appreciated the transition to off-site examinations, but also find value in in-person meetings and conversations with examiners. To improve

the examination process, bankers suggested that there should be more conversation and information sharing between examiners. They said examiners should be able to share their findings and practices specific to each bank and have easier access to information from previous examinations. This would lead to more efficient examinations and reduced burden for examiners and bankers.

Small business lending

The primary strength of community banks in small business lending was said to be their ability to build close customer relationships. Business customers value a partner that understands their unique needs and has a vested interest in the community benefiting from their businesses, bankers said. Community banks can make quick and local decisions, and small businesses appreciate the access to decision-makers.

Community bankers felt that it was important for them to be seen in a positive light in their communities. For example, being present at local events and sponsoring community events help to differentiate one bank from another. Being able to customize and promptly deliver services to the customer was seen as a strength of community banks. Understanding the specific needs of the business and its owners helps inform these critical relationships.

Embracing technological advances in banking

Bankers recognize that the financial industry is evolving with technology and that community banks must remain current with their customers' needs. However, before investing the time, resources and money in technological advances, they said that bankers should know the risks and costs that are critical to the decision-making process. Bankers felt that, to be successful in enhancing a bank's performance, technology must be

embraced by customers. The rollout of new products, where it makes sense, should be supported by proper training for staff.

Bankers stressed that technology should not be deployed just for the sake of having new technology; it should also improve efficiencies. Enhanced technology brings opportunities that the bank might not otherwise be able to access; the key is integrating those enhancements into existing core systems. Banks will have to focus more on strategic partnerships with core-service providers in enhancing technology applications and solutions.

Cyber threats

Although bankers in the state take different approaches to combatting cyber threats, all of them believed that the threat of an information breach or operational shutdown remains one of the highest risks to their institutions. One strategy mentioned to mitigate risk was through additional IT hiring and implementation of advanced cyber-preparedness technology. Another strategy was outsourcing IT operations and managing such arrangements through prudent internal risk management controls.

Bankers recognize the importance of enhancing their policies and procedures in connection to employees' use of electronic devices. They suggest limiting external access, such as external email capabilities, and increasing training for staff on breaches and response plans. Cyber threats are not expected to ease, and bankers have increased their commitment in recent years to manage this risk.



Kansas

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Bankers believe that industry consolidation will continue to increase. They noted that people are moving away from rural communities, adding more stress to smaller community banks. It was suggested that community banks focus on what their customers want and need. Some bankers mentioned that implementing technological innovations can enhance accessibility, product offerings and service offerings, thereby adding value to the community bank business model.

Tailoring bank regulation and supervision

Kansas bankers noted the need to increase off-site portions of the examination process and to utilize technology to improve communication between banks and examiners. The use of technology can also help with the transition to off-site exam functions, they said. One recommendation was to use a secure file-sharing portal to facilitate access to paperwork that examiners might need.

Small business lending

Community banks have an edge in areas where they have traditionally competed. Many bankers mentioned strong relationships with customers and flexibility to customize loan products to fit the needs of their customers. One said that banks need to be able to compete with marketplace lenders by offering better rates and terms.

Embracing technological advances in banking

Technological advances were seen as both an opportunity and a threat. Smaller community banks typically have a strict bottom line that they need to watch closely, which poses a threat to a bank that wants to keep up with bigger banks by trying out new technology trends. Bankers also noted that the opportunities technology brings to banks outweigh the threats. Banks are able to reach a wider range of customers by offering new products and improving existing ones through the utilization of technology.

Cyber threats

Being prepared and staying ahead are key to combating cyber threats, bankers said. By allocating manpower and technological resources to the risks involved, and by educating staff on new vulnerabilities, banks can be prepared for the possibility of cyber threats. Through self-assessment, banks are able to identify areas requiring additional investment.



Kentucky

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Kentucky's community bankers believe that community banks will still serve a purpose in the future, given that some customers desire to have a relationship with a local bank. The primary advantage of community banks is their ability to customize products and services to the specific needs of the customer. However, due to changes in policy, Kentucky bankers feel that they have less flexibility to provide customized products and services. Bankers in the state believe that complying with some of the rules and regulations is taking up too much human capital, which is reducing their ability to focus on customers' needs. In terms of industry consolidation, bankers believe that it will continue. An ongoing issue facing banks in Kentucky is the difficulty of achieving profitability goals while maintaining regulatory compliance. Kentucky bankers also stated that the barriers to entry into the banking industry are excessively high, as evidenced by the lack of de novo banks.

Tailoring bank regulation and supervision

Overall, bankers expressed frustration over current supervisory requirements. Most bankers feel that the multitude of documents they provide before and during examinations are not being used effectively. They suggested that using secure networks to communicate with examiners would increase efficiency and allow bankers to provide bank records and data for pre-examination processes. The most significant burden that Kentucky bankers have is compliance, mainly relating to customer lending. Community banks are losing out to fintech and online lenders, who have a higher risk tolerance on credit profiles and less regulatory oversight. They also expressed frustration that compliance

seems to focus more on government reporting than on protecting the consumer. Bankers suggested disclosures should be simplified and focus more on informing the consumer. Kentucky's community bankers appreciated the local decision-making ability and quicker response times of the state regulator.

Small business lending

Kentucky bankers feel that they excel in small business lending due to their strong customer relationships, community focus and local proximity. They can tailor their products to fit customers' needs by knowing their customers and understanding their businesses. Community banks have changed their processes in determining how to utilize physical branch locations. Since customers want more technology-based services and to go into the branch only when problems occur, banks have to be strategic in terms of where they place a location.

Embracing technological advances in banking

Kentucky bankers have mixed views on technological innovations in banking. Bankers interviewed felt that technology brings both opportunities and challenges to their institutions. Overall, the view towards implementing new technologies was positive. Technology can help equalize the playing field for large and small banks. Utilizing technology to offer products and services reduces the need for a physical location to provide banking services to customers. To overcome the challenges associated with adding more technology, some banks have added the position of technology integration officer. This person is responsible for reviewing fintech opportunities and determining if they fit into the bank's strategic plan. Despite the

costs, Kentucky bankers indicated they must adopt new technologies to remain relevant and competitive. The advice that bankers give is for community banks to really understand their customers' needs and to adopt technology that will be highly beneficial to their customers.

Cyber threats

The increasing trend of technology adoption in banks has Kentucky bankers worried about their banks' reputations since they are putting themselves at greater risk of breaches, attacks and disruptions in service. Kentucky's bankers are implementing programs to combat cyber threats, and although the risks can be managed, they cannot be eliminated. Some banks have hired in-house IT staff, while others have outsourced their IT functions. Another important factor in cybersecurity stressed by bankers was the importance of providing training to bank staff.



Louisiana

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Louisiana bankers believe that consolidation will continue, as larger banks are better positioned to drive profits and provide return on equity for investors. Bankers also pointed to aging boards and management as prompting a spike in bank sales and consolidation. While Louisiana bankers noticed past consolidation leading to de novo bank growth, regulatory burden has halted this trend. Regulatory burden has made new entry too costly and has further limited return on equity, pushing investors elsewhere. The burden on banks also has made it easier for less regulated fintech firms to serve as lenders. Community banks also currently face a shortage of trained labor, though a pivot towards automation may allow them to hire more trained employees.

Tailoring bank regulation and supervision

Community bankers noted that regulation has become particularly debilitating. While combining mortgage regulations seemed promising initially, these regulations have become onerous for bankers. Reports under the Home Mortgage Disclosure Act similarly have grown unwieldy, bankers said, with some adding that the reporting level could be adjusted to give smaller banks a break.

Bankers also would like examinations to be more targeted. There is a belief that strong exam procedures could be scaled back in

low-risk areas. Bankers also want to see regulators embrace a more technological approach to examinations and focus more on categories that are most related to the safety and soundness of a bank's operations.

Small business lending

Bankers tout their intimate understanding of the local economy and local decision-making as critical strengths for their small-business lending operations. Community banks take deposits locally and direct those funds back into the local economy. This relationship means that their success is dependent on their clients' success. Local relationships, efforts to work with their clients on securing credit, and rapid responsiveness are all features that help make community banks the go-to institutions for small business lending in Louisiana.

Embracing technological advances in banking

Technology is vital to community banks' competitiveness. As major players in the market continue to advance, community banks said they observe, investigate, evaluate and employ technologies that make sense for their institutions. Bankers on the technological forefront are adjusting to changing trends in banking through mobile banking, remote deposit capture, online banking, electronic funds transfer, bill pay, debit card alerts and customer-level controls. Community

banks are threatened by fintech firms and credit unions—both of which deal with less regulatory burden and therefore are rapidly encroaching on traditional banking markets.

Cyber threats

While cybersecurity remains an expensive endeavor, community banks use their funds strategically to ensure they are protected. They emphasize state-of-the-art security consulting, firewalls, spam protection, and substantial and ongoing staff cybersecurity training—all the while keeping software patched and equipment up-to-date. As cyber threats have grown, so has the focus on security by dedicated staff and board members of community banks.



Massachusetts

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Community bank executives in Massachusetts continue to have strong confidence in the community bank model. This model is built around face-to-face customer service, which is viewed as its greatest asset, especially when competing with large banks. Community banks combine high touch and high-tech to meet their customers' financial needs.

Bankers consider the current community bank customer as loyal; in order to attract new customers, however, bankers must offer innovative technology and new delivery channels. Most community banks expect consolidation within the industry to continue and view mergers and acquisitions as an opportunity. Regional community banks may become the norm for the industry, bankers said. Collaboration on fintech and other services, such as wealth management, is under consideration at many banks.

Tailoring bank regulation and supervision

Bankers consistently maintain that examinations should be risk-based and that exams and exam schedules should be tailored to individual banks. They also said that pre-exam input and submissions are important and request that as much work as possible be done off-site in order to lessen the burden on bank staff. Coordination between federal and state agencies, while good, could be improved.

Changes in exam processes to take advantage of technological advances have proven to be "game changing" for banks. While most bankers view the intent behind most regulations as noble, their complexity can be burdensome. Bankers suggest that during examination feedback, examples of weaknesses should be provided so that those issues can be better addressed.

Third-party vendors were said to be an issue because many do not share information needed for exams, nor do they share it in a timely manner. This can make it harder for banks to comply with regulatory expectations.

Small business lending

The customer-based approach to lending by community banks is a key to their success. Bankers said that face-to-face encounters with the "people making the decisions" can lead to securing loans even when pricing is not as good as that offered by larger banks. The speed and agility with which their loan officers can make decisions are keys to securing new business.

Banks are employing a two-pronged approach to retaining customers, including baby boomers, who are comfortable with the branch approach, and millennials, who are attracted to fintech. Referrals are also a big part of their business, particularly for smaller banks.

Embracing technological advances in banking

Community banks in Massachusetts see a place for both technology and branches. There is a risk in all technology but also a threat in not developing and using it, bankers said. Fintech is essential in attracting new customers, meeting the needs of new and existing customers, and making branches more efficient.

Banks identify themselves as latecomers (smaller banks), fast followers (medium banks) or innovators (large banks). Most community banks fall into the fast-follower category, preferring to wait until technology is seasoned and to respond to customers' needs rather than anticipating them. Most bankers think that the expense and complexity of fintech will lead to more collaboration among banks. Bankers also

are looking for new regulations on fintech and virtual currency that can protect the interests of the bank and its customers. Technology has also led to an increased skill set for bank staff.

Cyber threats

Community bankers agreed that the cyber-threat risk is enormous; some said existential. Cyber threats were described as the ultimate reputational risk. Banks are hiring full-time security resources, either in-house personnel or consultants, and taking a layered approach to cybersecurity. Training for both staff and customers, exercises to identify weaknesses, third-party audits and infrastructure updates are some ways that banks are responding to this threat. Many acknowledged that board education, documentation, incident response and risk assessments are vital. Managing vendors remains a challenge. A common remark was that cyber threats are what keep bankers up at night.



Minnesota

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Minnesota bankers agree that technology is vital to the growth and future of community banks. They said that community banks have to keep up with technology and make operating adjustments that reflect changing demographics in order to excel in today's evolving environment. A significant hurdle is optimally matching the community banking relationship model with the banking preferences of younger generations.

Tailoring bank regulation and supervision

Bankers believe there are a number of ways to improve the identification and monitoring of risks within a bank for supervisory purposes. Some suggestions include the creation of more granular peer groupings, adjustments to how examiners review a bank's loan portfolio, and increases in off-site work. In addition, they said consensus is needed as to how regulators and bankers define a small business loan.

Small business lending

Minnesota's bankers agree that small business lending is a major strength of community banking. They stressed the importance of fostering strong customer relationships when it comes to differentiating themselves from the competition. In addition, they said that highly trained professionals, experienced in business lending, allow community banks to thrive in localized markets.

Embracing technological advances in banking

Bankers agree that innovations in banking technologies present opportunities for community banks in the state. Banks have an opportunity to acquire new customers and enhance existing relationships as they implement technological advancements. One particular advantage to embracing technology in banking is the ability to reach younger customers. Advances in technology also provide an opportunity to better safeguard customer data. Increasing reliability in this area also can contribute to customer retention.

Cyber threats

Bankers are continuously evaluating different approaches for managing cyber threats. Risk assessment tools have been adopted and are actively monitored by experienced staff for potential threats. Some banks noted significant investments in internal and external audits of their IT systems. Continuous employee engagement and training in information security and cyber threats are top-of-mind for many Minnesota bankers. Strong cyber-preparedness can boost reputations within the community and reassure customers that financial institutions in the state are strong and can be trusted to protect consumers as they implement new technologies. For small community banks, any perception of weakness in this area can result in a jeopardized future.



Mississippi

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Mississippi's community bankers agree that the trend of industry consolidation is concerning. They also said that, without significant regulatory relief, this trend will continue into the future, ultimately resulting in fewer community banks across the country.

The role of community banks in meeting financial services needs in rural markets is unmatched by regional and larger banks, bankers said. Meeting customers' unique needs, including customizing banking solutions to better serve those needs, has been a longstanding goal of community bankers. As such, the approach taken in response to industry consolidation and the evolution of the community bank business model is centered on balancing the cost of providing personalized service with the cost of implementing technology to attract and retain customers.

Banks are struggling to find ways to absorb increased regulatory compliance costs, which one banker described as "dead-fixed costs," while maintaining personalized service. Some community banks seek growth as an offset to rising costs, which allows them to better compete with their larger counterparts. Others are outsourcing various operational functions in order to gain efficiencies.

Bankers recognize that human capital remains a critical component in the community bank business model; therefore, they are focusing on internal staff development to ensure that employees are adequately trained for managing operations and compliance systems. Many community banks are moving toward a more progressive, strategic planning process by incorporating more banking technology into their respective plans. Regardless of strategic vision,

bankers said, the viability of community banks is dependent on industry flexibility. One banker stated that the evolution of the community bank business model will undoubtedly change how he operates his bank, but that his commitment to customers and communities is steadfast. "Community banks will still be here in 10 years," he said.

Tailoring bank regulation and supervision

A common theme expressed by bankers concerned the need to right-size supervisory and examination processes. Specifically, bankers suggested using bank-specific metrics to develop relevant "exam request lists" and create examination scopes rather than using a uniform template for all banks. Continued and commensurate risk scoping is important, as bankers feel examiners spend a lot of time reviewing areas of a bank that pose minimal risks to the safety and soundness of an institution.

Bankers also would like to see more technology used in the examination process. For example, technology can be leveraged to create a more efficient information exchange, to develop more off-site monitoring tools and even to conduct more off-site exams. These suggestions could help eliminate redundancies in requesting exam information, contribute to the data analytics used to build exam request lists and scopes, and reduce the length of on-site exams. Bankers did, however, appreciate the value of periodic communications from regulators as well as outreach from examination staff.

A shared concern among bankers was the compliance examination process, specifically fair lending. Bankers stated that maintaining a compliance stance in this regulatory area is challenging and demands a lot of time and resources.

Small business lending

Community banks' small-business lending programs are focused on maintaining customer relationships and building new ones with the next generation. While rates drive some deals, bankers said that the best success in the small-business lending space comes from strong relationships. However, competition is making it more difficult to build and maintain these relationships.

One banker attributed the success of his community bank to its differentiation from large regional banks. He decided to capitalize on the size of his current market with the motto, "As they get bigger, we get better." With an increased emphasis on customer service and responsiveness, bankers believe that they have uncovered the value in community banking: relationships, reputation and speed of decisions.

Embracing technological advances in banking

Bankers consider innovations in banking technology as opportunities. They believe that technology has leveled the playing field between large, regional and community banks. This dynamic has allowed community banks to stay relevant and to expand their customer demographic.

Community bankers are building relationships through personal service and maintaining them through technology. Bankers also have embraced a wave of technological advances by using enhanced data analytics to proactively identify customers' needs while implementing enhanced mobile banking services and online account origination platforms. Other bankers have taken a more measured approach in implementing similar technology, such as phasing in mobile banking applications. Bankers are reassessing their branch networks

Mississippi *continued*

with respect to technology. They are also forgoing earnings for increased technological investments. While all community bankers agreed that technology is an opportunity, they also acknowledged that it opens the door to increased competition.

Cyber threats

Mississippi bankers are well aware of the impact that cyber threats have on the industry. As a result, the fear of a breach or compromise has served as a strong motivator in ensuring that effective systems are in place. Community bankers have taken proactive measures to upgrade disaster recovery plans and to perform vulnerability and network scans. They have also upgraded to more responsive firewalls that allow for quicker notifications, have hired additional IT staff and incorporated ongoing security training for all bank staff. In summary, cyber threats have forced a change in culture at both the bank and board levels in how to secure systems and view cyber preparedness.



Missouri

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Missouri's bankers note that the total number of banks with less than \$200 million in assets has dropped dramatically and is now at half the number reported in 2006. The small community bank is dying rather quickly, bankers said, but a continued emphasis on a relationship-based business approach could serve as the foundation for differentiating the industry from its competitors and serve as a successful business model going forward.

The downward trend in the number of community banks means that many local and rural municipalities no longer have access to traditional banking services, bankers said. Community bank consolidation will continue to accelerate because of the excessive regulatory compliance burden and the cost and complexity of expanding technology.

Technology enables community banks to reach customers outside their normal trade areas. Bankers said that the community bank business model will have to evolve to support more partnerships with fintech firms and other technological providers. This is necessary in order to support customer demand for products and services that compete with those offered by regional and larger national banks.

Small banks need to be more proactive in anticipating customer expectations. They must be willing to be early adopters and not take a wait-and-see approach, bankers said. As millennials age, smaller community banks will be at a competitive disadvantage since millennials generally do not value face-to-face interactions as much as other generations do.

Tailoring bank regulation and supervision

The likelihood that regulatory agencies will adjust their approaches based solely on size is extremely remote, bankers said. They added that bureaucrats in Washington write regulations and offer guidance with no comprehension of the inherent distinctions of local business environments or the costs that impact smaller institutions. Congress should reform regulatory compliance for banks with less than \$100 million in assets, they said.

Loan quality for most community banks is the largest area of risk and the biggest area of scrutiny for examiners, bankers said. They said examiners often review the same credits that were reviewed in numerous prior exams. They said examiners often are charged with testing for compliance and checking off a "procedural box" that, at times, does not provide any useful supervisory insight.

A transition to more off-site examinations is the one change with likely the biggest positive impact on reducing examination burden, bankers said. One banker noted overall that he is satisfied with the overall supervisory process but is frustrated by the underlying regulations. Quality capital, supported by strong core earnings, should be a prime qualifier for limited-scope exams or off-site reviews, bankers said.

Bankers noted that community banks do not have the resources or revenue streams necessary to justify the expert systems used by big banks to automate complex regulatory expectations. Others noted that the current level of regulatory guidance is overly complex, dysfunctional, incomprehensible, and is virtually impossible to administer absent highly advanced and expensive experts or systems.

Community banks cannot justify these system requirements, so they often abandon the segment (such as consumer lending) or agree to be acquired by a larger entity.

Small business lending

Small business banking is foundational for community banks, as the majority of smaller banks could not survive only on real estate loans. Community banks' strategic advantage is that the industry enables small business owners to have mutually beneficial business relationships with lenders involved in making the credit or servicing decisions. Therefore, a level of deep trust develops between small business clients and bank management.

Viewing the customer's long-term success as the bank's primary goal, rather than just making a loan, is a desirable approach insofar as it allows bankers to serve in a more consultative role. Bankers said this trust-based approach to relationship management cannot be replicated or standardized by the mega banks or fintech lenders. Most community banking markets still rely on and value an advisory relationship in lieu of online or nonbank service providers.

Embracing technological advances in banking

Bankers view fintech as both a threat and an opportunity. One banker noted that if the community banking industry does not embrace unique technological advances, the industry could cease to exist. Fintech lenders and payment processors are operating in several segments of the financial services industry, with share being taken away from the banking industry.

Missouri *continued*

Fintech players often need funding, clients or capital, which banks are able to provide. One banker is embracing technological advances in customer service by being one of the first in the market to offer video banking services; this bank also has updated its branch model to provide a “bank of the future” look supported by the use of technology. Customers are indifferent to banking technology or regulatory challenges, bankers said, and are willing to migrate to less secure, less regulated providers. This has the potential for creating significant risk in the future.

Cyber threats

One bank noted that the size of its IT department has doubled in the last four years, growing significantly faster than other operational areas of the bank. Additionally, this bank has contracted with more sophisticated and secure IT vendors that are able to better monitor traffic and abnormalities. Social engineering is seen as a huge threat. Bankers said they continue to train and retrain employees on cybersecurity awareness. Email filtering and monitoring, redundant firewalls, web filtering and monitoring, and encrypted emails are just a few areas of focus on the cybersecurity front.



Montana

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Montana bankers believe that industry consolidation will continue, but perhaps at a slower rate during this period of economic growth, increased loan demand and rising interest rates. They envision the community bank business model as continuing to thrive in Montana because of strong customer preferences for relationship banking.

Bankers do, however, expect further development of niche providers and remain concerned about how regulators view these entities with respect to concentrations. They also are concerned that the combination of Basel III capital requirements and the Current Expected Credit Loss model will cause a significant tightening of credit for consumers as bankers try to recalibrate the balance between earnings and risk of loss.

Tailoring bank regulation and supervision

Bankers generally feel that regulators over the past five years have done a better job of trying to examine banks in a way that is complementary to the community bank model. However, they believe more can

be done to exempt small rural banks from rules that simply cost the bank money and provide very little return to the consumer. They see opportunities for improvement in the continued refinement of appraisal rules and certainty around exemptions.

Small business lending

Montana community banks differentiate themselves when making small business loans by building relationships over generations and by being willing to take risks when a credit does not perfectly check all the traditional boxes. As one Montana banker explained, “Our credit box is more of a circle.”

Embracing technological advances in banking

Bankers in Montana believe innovation in technology is largely an opportunity, but they also see the potential threat that new ways of providing services can bring to an institution. Bankers believe that embracing technology is less of a choice and more of a necessity, especially for attracting the next generation of customers. The number of choices in both vendors and products

can be overwhelming, requiring banks to spend significant resources on product due diligence, from both a customer-interface and a cybersecurity perspective.

Cyber threats

Despite increased knowledge and focus by chief executive officers and boards of directors on cybersecurity, Montana’s community banks are still largely reliant on vendors to help manage cyber-risk. Bankers do appreciate Montana’s new IT examiner, who has an industry background and has been able to help banks identify cost-effective ways to pragmatically improve the cyber-risk profile of their institutions.



Nebraska

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Community banks will continue to stay viable and grow, even with the current trend of industry consolidation, according to Nebraska's bankers. They believe that consolidation is largely prompted by leadership succession issues, changing rural demographics and the unavailability of managerial talent. However, they are divided on how to overcome these challenges; some bankers want to promote local investment opportunities as a way of tackling outmigration, while others want to develop local talent. Despite these challenges, bankers expressed a general level of optimism, indicating that the community banking model "wasn't broken."

Tailoring bank regulation and supervision

Bankers strongly emphasized the importance of good working relationships with the regulatory community. Some bankers stated that more off-site examinations and reviews would be helpful to community banks and could relieve some of the extra burden on both examiners and bankers. Many bankers wanted to increase reliance on the use of regulatory risk profiles.

Small business lending

Bankers agree that customer focus is the major strength of community banks in small business lending. They believe that success in this type of lending is achieved through recognizing the importance of relationships and culture. Following are some of the approaches that community banks have taken to stay competitive: a holistic understanding of the local collateral surrounding the bank, speedy decision-making, and the ability to adjust to each customer to determine appropriate approaches and solutions.

Embracing technological advances in banking

Bankers view technology as a way of enhancing and securing relationships with customers by improving customer service and servicing product lines. They said that bank employees have taken an interest in, and have increased their training associated with, fintech products. Overall, bankers do not perceive fintech products as threats, but they do recognize that nonregulated products can potentially harm a bank's reputation.

Cyber threats

Bankers said that the main challenge in cybersecurity is protecting customers' personally identifiable information. The effective management of cyber-risk involves appropriating the right amount of capital, time and training while being cognizant of any reputational risks. Banks in the state have experienced challenges in attempting to evaluate and implement new hardware and software infrastructures as they become increasingly focused on cybersecurity. Bankers stated that they do not expect the costs and time associated with managing cyber-risk to decrease anytime soon.



New Mexico

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Community bankers in New Mexico believe that banks in their state may need to reach \$500 million to \$750 million in assets to survive. They lament the amount of time and money that their banks spend on compliance, with one banker saying, “It is almost as if Dodd-Frank was intended to kill community banks.”

Bankers said that they have had to pull money from community interests (sponsoring Little League Baseball or local charities, for example) to pay for increasing compliance costs. While they believe there will always be a need for community banks, the compliance burden means that almost half of bank staff does non-income-producing work.

Succession planning also plays a part in the consolidation threat. One banker said he does not want his kids in banking, citing the stress and major compliance burden. Bankers also said it is difficult to keep top talent. Some banks are offering long-term benefits, such as stock appreciation rights, to deter employees from leaving. Other threats to the business model that New Mexico bankers noted were an uneven regulatory playing field, particularly with regard to credit unions and the Farm Credit System.

Tailoring bank regulation and supervision

Bankers said that the Community Reinvestment Act needs to be reviewed. It does not give credit for tasks that should qualify, and its inconsistent standards have caused difficulties for community bankers. Many bankers feel that they have been accused of redlining and have spent significant amounts of time and effort to prove otherwise.

Additionally, these bankers have concerns about the Current Expected Credit Loss model and the lack of “real guidance,” as well as with the Home Mortgage Disclosure Act. Bankers want examiners to work with a common-sense mentality and a proactive approach. Other complaints involved the length of the Federal Financial Institutions Examination Council’s Call Reports and the current 18-month examination cycle.

Small business lending

One community bank has an 80 percent share of its market, which it attributes to its “elite” customer service, minimal competition, culture and diversification. Bankers said that small businesses do not fit into big banks’ “boxes” and that they are able to provide these businesses with flexibility and a trusted partnership.

Embracing technological advances in banking

Bankers see technology as both an opportunity and a threat, with the threat being high expenses and rapid change. A problem some community banks have encountered is that some older board members tend to fight against technology, so change can be difficult.

While IT staff can provide much-needed support, partnering with fintech providers may offer opportunities for superior products. Bankers said that if a bank is not digitally driven, it will lose market share immediately. While some components of traditional banking might be great for good customers, it is imperative to offer modern technological features.

If good customers relocate, inadequate technology forces them to find another bank. It is critical to be at the forefront

of technology through general awareness, internal training and customer education (one-on-one conversations and literacy brochures, mailers, etc.)

Cyber threats

Bankers view cybersecurity as a priority. One bank owns and operates its own data center, but is finding it an increasingly costly way to mitigate risk. One bank noted that its staff actively addresses cyber threats within a 30-day time horizon, delivers intrusion emails internally for testing and training, uses secured mail for outside sources and does not allow remote access to core activities. Bankers said they have recently embraced use of the cloud.

Cybersecurity is core to risk management. Banks spend a lot of money on IT and will continue to do so. Additionally, bankers acknowledge that education at all levels is critical.



North Carolina

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

North Carolina bankers acknowledge that consolidation is occurring but still believe that community banks are vital to local communities. They said that adjustments in business models are mostly being made to accommodate all generations of customers. Some smaller banks are moving toward digital operating systems.

Bankers stressed the importance of connecting with the customer and establishing good relationships and trust. Several bankers believe the regulatory playing field needs to be leveled; one banker said that changes in regulation and supervision would not be enough to stop consolidation.

Tailoring bank regulation and supervision

North Carolina bankers universally agreed that risk-focused and tailored examinations are important. They called for simpler examinations for small banks. Several bankers suggested that consistency was key and that all examiners should apply standards in the same manner.

One banker suggested wholesale relief from some mortgage requirements for mortgages held in portfolio. Other bankers suggested reducing the number and frequency of third-party reviews. Materiality of findings remained a major concern among bankers, particularly in the compliance arena.

Only a few bankers recommended extending the examination cycle to 24 or 36 months, and even then, only for banks with a demonstrated track record of strong performance. Bankers said that regulatory reporting and evaluation had become excessive, particularly for

those institutions with fewer than 10 employees. Suggestions for improvement included eliminating examinations under the Community Reinvestment Act for institutions with less than \$1 billion in assets, eliminating stress testing for community banks, conducting examinations jointly and setting a flat-rate allowance for loan losses based on examination ratings.

Small business lending

Bankers in North Carolina agreed that key differentiators for small business lending include local decision-making, face-to-face interactions and knowing the business climate of the community. They are very hands-on and spend a great deal of time engaging with borrowers in person. Successful business lenders treat their commercial lenders as a resource for commercial borrowers.

Embracing technological advances in banking

Most bankers described innovation in technology as an essential opportunity for the future of banking, provided that regulatory requirements are applied equally across nonbank providers, such as online small business lenders and home mortgage lenders. New mobile-enabled payment systems were also viewed as an opportunity. Bankers view technology as a means to deploy traditional banking principles in a more efficient, automated manner. Some bankers noted that their customers are concerned about cybersecurity; consequently, these bankers do not view fintech as any kind of threat, since their customers prefer face-to-face interactions.

Cyber threats

Bankers universally reported that cybersecurity is a chief concern because they take the community's trust in them seriously. They said that North Carolina bankers outsource IT compliance despite the additional cost of vendor due diligence. Vendors typically provide bankers with ongoing systems monitoring, patch management and periodic vulnerability testing.

Several bankers use online training, regular meetings, bulletins and updates on cyber threats to train employees and customers in a defensive effort to boost cybersecurity. These bankers noted that cyber threats cannot be eliminated entirely and must be managed like other risks. At least three bankers indicated that they do not offer online account access or interactive website access specifically because of cyber-risk.



Future of the community bank business model

Ohio's bankers are expecting substantial changes in technology within the banking industry. Bankers said that smaller, less complex institutions cannot acquire or implement technological platforms at the same cost as larger competitors; consequently, the community bank business model will suffer if smaller banks cannot compete with larger banks. One banker optimistically noted that technological competition is possible, but said it is becoming increasingly difficult to compete for quality employees and to maintain appropriate staffing.

Tailoring bank regulation and supervision

Community bankers would like to see additional regulatory relief. There are now multiple lenders and lending platforms, they said, and not all of them are regulated to the same degree as banks. The role of fintech firms and the appropriate method to regulate them are expected to be concerns within the next 10 years.

Bankers stated that compliance examinations need to be more risk-focused and administered more fairly. Community banks are not on a level playing field regarding the Community Reinvestment Act (CRA); bankers said they are hamstrung by CRA and consumer compliance regulations. Regulatory agencies need to have more robust conversations about modernizing CRA and the corresponding examination processes.

A risk-based approach is emerging on safety and soundness examinations, but the cost to small banks is exceedingly high. Meeting the metrics being applied today will be challenging over the next 10 years.

Small business lending

Community banks must differentiate on service and must use available technologies to make quicker, more streamlined credit decisions, bankers said. As big banks exit small business lending, it can be easy for a community bank to reach its lending limit very quickly.

Some bankers noted an overall disappearance of small businesses. Many businesses are moving out of rural markets into urban areas. They said the ability to leverage technology can help banks retain these customers even if they move outside of the market.

Embracing technological advances in banking

Technology should be viewed as an opportunity for the future, bankers said. They also are seeking regulatory guidance regarding vendors, as large vendors are not familiar with pertinent interagency guidance. They noted that other fintech companies are now beginning to offer services that have traditionally been banking activities and that millennials do not always differentiate between deposits insured by the Federal Deposit Insurance Corp. (FDIC) and an account with a fintech company.

One particular technological challenge for community banks is differentiating themselves from large banks. Technology for the community bank business model should be used to further enhance customer relationships.

Cyber threats

Cyber-risk is now a regular topic for committees and boards of depository institutions. Bankers are seeking to follow the best practices that have been published and to utilize the various tools that are available in the marketplace. Cyber insurance providers are getting better at tailoring their services to banks. The inherent challenge is data storage and who has access to it.



Future of the community bank business model

Oregon's community bankers expect consolidation to continue across the industry. The primary driver of consolidation is the need to achieve economies of scale in order to be competitive with large banks, credit unions and fintech companies, as well as to deal with the increasing number and complexity of regulations. Most bankers agreed that \$200 million is the minimum asset size needed for a bank to be viable in this environment. One banker said he believed his \$750 million bank is right-sized to handle regulatory and operational challenges while still providing a reasonable return for investors.

Consolidation also is being driven by competition from large banks and credit unions that offer a full suite of services and can afford to provide their customers with access to new products and technologies, such as mobile banking. While some small banks currently do not offer full-service mobile banking, they all expect the need to do so in the near future to remain relevant and competitive. One banker said that while a small community bank may be able to initially attract a new local customer account, the customer at some point is likely to be drawn to another institution that may not even have a nearby physical branch but offers a full array of products and services, including mobile banking.

Bankers said that today's community bank model, while still primarily relationship-based, is being forced to add functionality and become more technology-centered in order to remain competitive with fintech companies. Credit unions are a growing threat because of their expansion into business lending. Bankers universally view competition from credit unions as unfair because of their tax-exempt status.

The recently passed Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) is likely to further change the market for mergers and acquisitions, bankers said. Now, regional and super-regional banks are both buyers and targets for acquisition. One of the bankers interviewed predicted that, in the future, smaller metropolitan areas will be able to support only one community bank because of the presence of regional players, larger national banks and credit unions. As an example, he said that in 2008, there were five community banks in Eugene, Ore., a city with a population of approximately 170,000. Today, there is only one.

Tailoring bank regulation and supervision

Oregon's community bankers said that more should be done to tailor supervision to the size and risk profile of banks and business models. Many bankers view their operations as "plain vanilla" and feel their institutions continue to function with a small-bank mentality even as they grow larger. Accordingly, they would like to see a level of regulatory supervision and oversight that is based primarily on an institution's risk profile, not on its size.

Bankers expressed concern that regulatory requirements and examination procedures that were put into place to address issues unique to larger, more complex institutions tend to trickle down all the way to the smallest banks. The kinds of problems or complex products found at large institutions simply do not exist at community banks.

Bankers were displeased with the size of the examination teams that are sometimes sent to their banks. Several of them suggested that more of the examination be conducted off-site, especially given the availability of web-based technology and loan file imaging. Bankers also expressed frustration with the large number of items requested

by examiners, particularly since some of the items appear not to have been reviewed by the examiners.

Bankers said the Community Reinvestment Act needs to be modernized, given the growth of online banking and the expanding marketplace in which an institution can effectively operate.

Small business lending

The recent merger of several Oregon banks with out-of-state banks is creating new opportunities. However, community banks are seeing increased direct competition in small business lending, primarily from credit unions. Competition from fintech firms is still limited, though it is increasing. At this time, it is not clear when fintech firms will make significant inroads into the types of small business lending that banks actively engage in, but companies like Quicken Loans are doing well in residential mortgages, bankers noted.

The greater availability of information and wider array of product choices have made borrowers more price-conscious, bankers said. As a result, community banks are often pressured to match the low rates and/or liberal terms offered by these other types of financial providers. Banks have not changed their small-business loan underwriting standards or risk tolerance levels over the past few years. Competition for good loans is intense. As a result, loan yields have not improved commensurately despite the general rise in market interest rates.

Several bankers indicated that the fixed cost of doing business demands that they make larger loans. One banker indicated that a few years ago, his bank may have been able to make business loans as small as \$50,000; these days, he said, a loan needs to be at least \$250,000 to be profitable after covering the cost of making and administering the loan and the cost of funds.

Oregon *continued*

Embracing technological advances in banking

Technological change presents both threats and opportunities for Oregon's community bankers. They agreed that embracing technology is imperative if they want to remain relevant and competitive, though one banker was quick to point out that "bad tech is worse than no tech." For example, a poorly designed website can cause a bank to lose customers. As one banker summed it up, his bank is willing to adopt new technology as long as it improves client relationships, advances efficiency or aids in compliance. Bankers realize that people are not going to the bank like they used to, so banking products and services need to be brought to them.

Community banks are deciding how they want to be positioned on the wave of technological change: on the leading edge, somewhere in the middle or lagging behind. Clearly, the adoption of new technologies provides opportunities to do things more efficiently and to offer new and innovative products that customers want. However, cost is a major concern. The challenge for small community banks is that they cannot afford to develop proprietary solutions. They must rely on software and technology provided by third parties, which introduces different risks and requires enhanced vendor management approaches.

Directorates of community banks generally are comprised of older individuals, and their knowledge and understanding of new technologies—including the risks and benefits of those technologies—tend to be limited. As a result, convincing older board members of the benefits of acquiring new technology in light of the investment can be challenging.

Cyber threats

Bankers view cyber threats as one of the primary risks facing the banking industry today and are taking cybersecurity very seriously. There is recognition that small banks with relatively small IT budgets are potentially more vulnerable. Community banks are working to add specialized knowledge to their boards and are leveraging third-party vendors to strengthen their IT and cybersecurity functions.

Given the growing risk, one banker recently brought on a new audit firm that had significant IT expertise. Another indicated that his bank had significantly strengthened its disaster recovery plan and added a new firewall costing \$35,000. This bank also sought to add redundancy at the branch level, giving it a separate firewall and LAN network, and is focusing resources on training and effective patch management. Another institution has outsourced network services in an effort to control costs.

Bankers understand that no matter how much the bank spends on state-of-the-art IT systems and security, if an employee "opens the back door," a bank's assets and confidential customer information can be easily exposed. In this regard, banks have significantly strengthened employee training. Bankers said threats from social engineering are being well managed. One banker said his employees' fail rate on social engineering was as high as 40 percent a few years ago. Today, with the help of security awareness training and ongoing audits by a third-party vendor, the bank has achieved a zero fail rate on social engineering reviews for seven consecutive months.



South Dakota

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

South Dakota bankers expect continued consolidation in the state because of technological and regulatory costs that burden rural banks. The most challenging long-term issue for rural community banks is management succession.

Community bank consolidation is in many ways a microcosm of what has been occurring in local communities for many years. The farms and businesses served by community banks also are consolidating, which leaves fewer customers to serve in a local market. Credit needs remain, but in many cases, they have grown much faster than community banks and therefore pose lending-limit challenges. There also is a generational component to these changes: As long-time customers retire or die, their money passes on and, in many instances, moves out of the community. This trend is likely to put pressure on the funding side of community banks from a core deposits perspective.

Another concern noted is that even if a local bank remains open after a merger or acquisition, the loss of local ownership and resulting economic impact pose new challenges for the affected community. One South Dakota community bank is working to address these issues by structuring itself to ensure perpetual local ownership proportional to its branch network. Its end objective is to spread out the economic benefit of bank ownership among the communities it serves and to maintain local leadership in those communities.

Tailoring bank regulation and supervision

Multiple bankers said great strides have been made in supervision and, as a result, they no longer fear examinations as they did 10 to 15 years ago. The bankers particularly appreciate the efforts to

make the on-site portion of examinations less time-consuming. However, one challenge cited by South Dakota bankers is the experience of examiners; having inexperienced examiners does not add value to the supervisory process and delays the exam cycle. One suggestion was for supervisory agencies to explore the possibility of a 24-month examination cycle for small, well-rated and highly capitalized banks.

Another issue identified by one banker is the time spent on evaluating capital and loan-loss allowances given the level of agriculture loans to assets at South Dakota banks. The banker noted that ratios on these metrics remain relatively unchanged, even though farm income has drastically decreased from five years ago and land values are down 20 percent to 30 percent from their peak.

Small business lending

Knowing the customer, being able to make quick decisions, and providing good and timely service at a reasonable cost are crucial to small business lending. South Dakota bankers believe reputation and “word of mouth” are the best forms of advertising when it comes to new lending opportunities.

Bankers did note a significant difference in small-business lending opportunities for banks with locations in large or fast-growing communities when compared with banks with a limited number of locations in smaller, slower-growing or more rural communities. In the latter communities, fewer businesses are being formed, and those businesses already established are not seeking additional funds to expand due to a lack of consumer demand.

Embracing technological advances in banking

Bankers acknowledged that innovations in banking technology present opportunities

and threats. On one hand, technology is a great way for banks to advertise their services and to reach new customers; for example, small banks have been able to keep younger customers through mobile banking products. On the other hand, threats from technological advances include the growing dependence on third parties and the possibility of banks losing some of their individual identities. The latter is particularly acute for smaller banks, as their operations are very dependent on third-party vendors that often provide the same products and services to other banks. Thus, many smaller banks note that technology has made them look very similar to each other, which affects competition. Overall, community banks said they cannot fall behind in technological offerings and need to be cognizant of the opportunities and threats of these new advancements in technology.

Cyber threats

South Dakota banks are implementing a mix of third-party expertise and internal capabilities to increase the management of cyber-related threats. Outsourcing the day-to-day IT security duties is expensive and increases banks’ dependence on third-party services; even so, almost all community banks have engaged these vendors to help with cyber threats. Additionally, most banks have increased their internal capabilities to provide oversight of the functions inside the banks and to help manage their relationships with the third-party vendors.

Finally, banks said that ongoing training for all employees is critical. Bank employees want to help their customers, but they need to be vigilant to guard against the numerous and varied threats in the marketplace.



Tennessee

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Tennessee bankers foresee continued increases in community bank consolidation. The community bank business model could evolve from providing a full array of general banking products and services in all market segments to becoming specialty financial services providers focusing on consumer, small-business or professional markets.

However, traditional community banks serving a limited number of contiguous counties will continue to exist outside the major metro areas. According to one Tennessee banker, “The personal touch that community banks can provide their customers will always be what sets us apart from the larger institutions.”

Bankers said increased regulatory burdens on community banks create personnel challenges. Finding skilled employees who are willing to “wear many hats” gets more difficult with each year. Acquiring other banks is one of the fastest ways to grow, not only in assets and footprint size, but also in the number of employees needed to run the bank efficiently. But there are concerns associated with consolidation through acquisition, including the loss of a personal touch.

With sensible regulatory oversight, it is possible for community banks to thrive while fully serving their markets, bankers said. However, they said the “disclosure nightmare” of closing a loan needs to be addressed by Congress in order for borrowers to have a simple and clear understanding of the key aspects that they need to know. “If the borrower cannot understand the 25-plus forms they sign,

then Congress and regulators have failed miserably in protecting the borrower,” one Tennessee banker commented.

Tailoring bank regulation and supervision

Tennessee bankers support right-sizing the exam process. A “common sense” approach to supervision, they said, would entail focusing on the risks of a specific institution. They believe that examiners should identify the true aspects of risk oversight and stop examining each bank as if it were a large and complex institution. Risk differs for each bank; an activity that one bank deems risky might be accomplished at another bank with little risk involved. Asset quality and IT are the risk drivers of the future.

Having seasoned examiners with knowledge of the bank’s history, philosophy and recognition of the strengths of the management team would help tailor the examination process, bankers said. Working together to build a solid foundation of mutual respect and communication between banks and regulators would help create a long-term partnership; this will be what makes or breaks the success of the examination philosophy. As one banker stated, “Regulation must evolve to be meaningful.”

Small business lending

Tennessee bankers are concerned that many aspects of the current compliance examination process could carry over to small business lending. This could lead to approval processes that will be primarily automated, and the ability for a qualified banker to effectively counsel a business client will disappear as bankers become information gatherers.

Lenders should be committed to being trusted advisers for business customers; their success becomes the banks’ success. To accomplish this, lenders have to be educated, capable and truthful at all times. Some small business owners are wonderful at creating and selling their products or services but ignore other important parts of their business to their detriment. Customers need lenders to help them understand all the areas that they need to focus on and to offer guidance and products that can make their businesses stronger. Community banks primarily accomplish this through the strong relationships they build with their customers.

Banks also have to be willing to provide value-added services, such as participating in the New Markets Tax Credit Program. One banker said, “It was a very tedious and challenging process to learn, but we believe our diligence and assistance not only benefited our customer and the bank, but will have a profound impact on the economic development and health of our community.”

Embracing technological advances in banking

Bankers consider innovations in banking technology both an opportunity and a threat. Technology provides an opportunity to reach out and capture customers in ways that could not be done before due to limited branch networks and the prohibitive cost of marketing. It is also a major threat due to the investment, maintenance cost, staff and customer education, and training required to effectively utilize emerging technologies and manage cybersecurity threats.

Tennessee *continued*

To meet customer demands and deliver a valuable customer experience, banks must embrace new banking technologies. Early adopters will have the edge over their peers, and this will help them stay ahead of other digital-only competitors, bankers said. Many community banks are dependent on third parties' relationships for innovation within the banking technology world, which means that vendor management has never been more important. Success will hinge on having employees skilled enough to support the transition process for banking customers as they learn to adapt to the new technologies offered to them.

Cyber threats

Maintaining a layered security approach is essential. Education must be at the forefront to assist in mitigating many threats, bankers said. The tone should be set from the top with the board. In addition to providing continuing education and training employees, banks should develop, implement and test a comprehensive information security program as well as perform annual information security and cybersecurity risk assessments.



Future of the community bank business model

Community bankers in Texas see threats to the community banking business model due to changes in customer expectations, the evolving economic climate and developing technology. Emerging technologies have led to changing needs for community banks and their customers. One banker noted that customers, especially millennials, are using internet-based payment systems and sophisticated mobile platforms offered by larger banks.

Other challenges come from pressure on net interest income, changing demographics in rural areas, downward pressure on noninterest income and decreasing loan demand. To compensate, one banker suggested that community banks need to change the way they compete with credit unions and larger banks.

Bankers in the state generally feel that consumers would prefer to do business with their banks as opposed to with their competitors. To retain younger customers, community banks need to offer better loan pricing and provide electronic banking. Internally, banks need to find ways to reduce their operating costs and increase their scale to maximize revenue and take advantage of new business opportunities. Bankers are optimistic about the effects of enacted banking legislation.

Tailoring bank regulation and supervision

Texas bankers are focused on tailoring examination processes to reduce burden on their institutions. Bankers in the state believe that the scope of exams should be based on past exam performance. They also believe that exam cycles should be lengthened and that more work should be

completed off-site. In addition, bankers suggested that regulators should have a better understanding of each bank prior to commencing an exam. Ideally, exam teams would be consistent from exam to exam. Interviewed bankers also suggested that the examination functions of the Federal Deposit Insurance Corp. (FDIC) and the Federal Reserve should be reduced and that the state should serve as the sole supervisor for state-chartered banks.

Small business lending

Community banks in Texas set themselves apart in small business lending by focusing on people and relationship-based business practices. One banker noted, “We may not offer all 31 flavors, but we do offer the five most important to our clients.” Along with a strong focus on their customers, bankers also understand the importance of focusing on their staff and who they hire. Having a staff with deep roots in the community will provide a bank with more opportunities to serve a wider range of customers.

Embracing technological advances in banking

Bankers said the opportunities that emerging technologies bring to their banks outweigh the risks that also come with investing in innovation. One banker foresees the most potential in loan processing and new account openings, both of which can increase efficiency for the bank and its customers. Increased technology also would allow banks to be less dependent on branches, resulting in reduced overhead costs. For community banks that do not have as much capital to put into technological trends, online platforms like Venmo and Rocket Mortgage are seen as threats. However, several bankers are

optimistic about the potential of reaching new customers through partnerships with fintech companies.

Cyber threats

A primary focus of Texas bankers is educating their staff and customers regarding cyber threats. Most banks monitor cyber risks both internally and externally, while some have 24/7 firewall monitoring and IT experts on their boards of directors. Banks also are focused on the performance of IT audits, which can include internal penetration tests, social engineering tests and external penetration tests. Bankers also noted that staff must be trained annually on the newest information security threats.



Future of the community bank business model

Savings bankers in Texas see consolidation as a continued and necessary trend but believe that community banking will remain viable if they adopt new technological trends and maintain involvement in their communities. They believe that they must drive innovation and work with third parties to provide new financial products to help them stay competitive regardless of regulatory burden and competition.

Tailoring bank regulation and supervision

The bankers say a highly intelligent and well-trained examination force is key. They value relationships with their examiners and want a portion of the exam to remain on-site and in person. They are especially complimentary of their examiners and feel that examination staffs provide great insights and suggestions.

Small business lending

Texas savings bankers take advantage of their ability to meet with customers and make decisions quickly and in person. Small business lending is their specialty, and their knowledge of the local community is extensive. Lenders working within community banks in the state are knowledgeable regarding lending programs, tax credits and other state incentives that allow them to serve customers in a specialized way. The ability to customize loan products and avoid cookie-cutter loan products also sets them apart.

Embracing technological advances in banking

Five years ago, many savings bankers in the state found themselves apologizing for lagging behind in technology. Today, much progress has been made to innovate and to adopt emerging technologies. Bankers consider technology to be an opportunity and are constantly focusing on how best to improve. They use best-in-class technology but also recognize that their banks do not necessarily have to be pioneers in adopting new technologies.

Cyber threats

Texas savings bankers seek the most knowledgeable personnel who have the capability to keep up with the best available systems and methods offered by IT security experts. They use third parties to measure and test current processes and are constantly focused on improvement. They make use of a layered security approach, utilizing multiple vendors to watch systems and monitor events as they occur on the network. They prioritize educating employees on phishing attacks, fraud and check fraud. One banker noted they have five daily reports reviewed by three different people. Cyber fraud is increasingly an issue, and several banks have considered hiring specifically in this area.



Future of the community bank business model

Utah's community bankers worry about the viability of their banks due to the ongoing trend of industry consolidation. One banker said that mergers and acquisitions are a natural process of the free market. But in order for community banks to mitigate risk, more de novo activity is required.

Creatively changing the status quo would enhance the viability of community banks. One banker emphasized the need to add technology, an industry necessity in today's environment.

Tailoring bank regulation and supervision

Bankers' primary proposal for improving examination processes was to tailor the requirements more closely to specific banks. Bankers also recommended customizing the exam process to fit the size of the institution and its profile with respect to risk and complexity.

Small business lending

Bankers said they emphasize relationship-based banking. They believe that the best way to differentiate themselves from competitors is by giving face-to-face attention to their customers. Another key factor is the ability to tailor products to fit the needs of their customers. To stay competitive, one banker recommended online services but also said that online customers should be contacted to create a personal touch.

Embracing technological advances in banking

Technology is viewed as a way to equalize the playing field with larger banks. The struggle faced by some community banks in Utah is the need to deliver the personal interactions that customers seek from a bank of their size while still being on the leading edge of technology. Two bankers are worried about technology emanating from outside the banking industry, such as from nonbanks and fintech firms. They believe those companies have a lot more capital to spend on research and development, an area not traditionally affordable for most small banks.

Cyber threats

When it comes to cyber threats, Utah bankers place a strong emphasis on risk identification. Since technology is always evolving and changing, banks that utilize emerging technologies need to remain on the cutting edge when it comes to cybersecurity.

Some banks have dedicated additional resources to help protect themselves by hiring full-time cybersecurity or information security officers, purchasing new software or hiring third-party firms to monitor and keep track of technology. To stay on top of emerging threats, bankers recommended utilizing tools offered by the Financial Services Information Sharing and Analysis Center (FS-ISAC), as well as the Cyber Assessment Tool of the Federal Deposit Insurance Corp. (FDIC).



Virginia

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Virginia's community bankers said pressures on the community banking model have put a premium on efficiency. Bankers expressed a need to react to market demand in delivering products and services the way customers want to receive them. They expect industry consolidation to slow but continue at a moderate pace. They intend to focus on the communities they serve and to continuously evolve by using technology as well as in-person customer and community engagement.

Tailoring bank regulation and supervision

Bankers support the use of more off-site analysis to determine the need for, and extent of, on-site examination work. They would prefer more interagency communication and coordination of examination activities, which could mitigate regulatory burden. They also would prefer more experienced field examiners, as opposed to trainees, which could mitigate inefficiencies in having to reintroduce new examiners to a bank's operations.

Small business lending

Bankers said close customer relationships and in-depth knowledge of small businesses help differentiate them from their competitors. They have embraced technology in order to streamline the underwriting process, thereby quickening loan decisions. They also have worked hard to educate their small business clients in areas outside of banking, demonstrating awareness of their challenges, needs and financial positions.

Embracing technological advances in banking

Virginia's bankers see both threats and opportunities presented by innovations in banking technology. They said they need to adapt in order to better meet customer preferences.

Cyber threats

Investing in education, from the board level to each employee, was cited as a way to reduce vulnerabilities to cyberattacks. Bankers also are working with third-party partners to assess their systems and controls and to assist with critical responses to system breaches.



Washington

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Most Washington bankers still believe there is a need and future for community banks. They said that innovation is required to stay relevant. Community bankers believe they need to remain relationship-driven and keep their personal touch, but also must strike a balance with strong service delivery systems that can adapt with the changing times.

Bankers are fighting a flattening yield curve, lost fee income on the consumer side and escalating costs on the regulatory compliance front. Core profitability is under attack from outside competition, with a growing presence from fintech firms. More and more institutions are faced with the question of whether to sell out, and some economic outlooks say that banks may be reaching peak profitability as an industry. Boards are being asked to either sell or define a viable business model to remain independent.

Bankers said the community bank model is evolving. Through partnerships with fintech firms or embracing digital banking, some banks report taking unique paths to success.

Tailoring bank regulation and supervision

Bankers offered the following advice for regulation and supervision: First, they would like to see more off-site examination reviews. With technology and modern imaging, they contend it is unnecessary to have “18 examiners onsite for 2½ to 3 weeks.” Second, they want longer periods between exams. For example, one banker recommended 24 months between exams for well-rated institutions. Third, bankers would like to see a two-tiered regulatory process. This would lower the burden on community banks and allow them to avoid regulatory changes, such as the Current Expected Credit Loss standard, which seem inappropriate for smaller institutions.

Community banks are adjusting to the times, and these adjustments should be a priority for the regulators to understand. As an example, community bankers cited the CAMELS system as a flawed one-size-fits-all approach to risk examinations.

Small business lending

Most bankers said that “service sets us apart.” They get involved in the communities they serve and focus on improving the products and services they offer.

An example is one bank’s project with an online banking platform that utilizes artificial intelligence and has an open application interface. Loans offered using this program are typically around \$130,000. This platform has allowed the bank to onboard small business customers quite well. Personal service with automation is key, this banker said. Three years ago, the cost to book a small business loan for this company was \$1,400. With the new platform, the cost is down to \$700 per loan. The ultimate goal is to continue increasing efficiency for the bank and its customers. Bank management noted that they can do this by removing barriers in the process, increasing speed to market and easing the process for submitting applications.

Embracing technological advances in banking

Community bankers in Washington said that technology is both a threat and an opportunity. Embracing technology is necessary; failing to do so would spell the demise of community banks in the state. Disruptions caused by new technology are forcing institutions to reevaluate strategy but also are providing the opportunity to reach new customers.

Cyber threats have become prominent in discussions in every board room. As technology advances, new avenues arise for bad actors to gain access. Most bankers said that they do not want to be on the

cutting edge of new advancements due to risk. But they also said that change and adapting to technology are necessary. Most bankers are focusing more time at board and committee meetings on technology and cyber-risk.

Bankers insist that all new technological implementations should be well thought out, with sound business practices established in advance. Decisions should be driven with sound risk perspectives and not zeal.

Cyber threats

All community banks in the state are adding resources in this area, and there is a general understanding that there is a need to evolve away from a reliance on one technology person or one vendor. In today’s environment, the risk is too much for one person to manage systems full-time without support. Some institutions have moved toward hiring a chief cybersecurity officer to oversee tactics in this area. Costs to increase cyber-preparedness are substantial; spending \$150,000 to hire one individual and \$150,000 more to implement tools to support monitoring are not uncommon.



Future of the community bank business model

Community bankers in Wisconsin believe that industry consolidation will continue, but that the need for community-oriented financial institutions will still be evident in communities across the nation. Bankers see value in the community bank business model. They noted that community banks increasingly have been filling specific niches to survive.

Bankers are wary of threats facing the community bank business model posed by competitive pressures from large fintech companies. Bankers also are concerned about rural depopulation, which is causing customer and employee pools to shrink.

Tailoring bank regulation and supervision

Bankers emphasized the importance of tailoring supervisory processes to a bank's size and complexity. Community banks are not as large or as complex as systemic financial institutions, they said, and that difference should be reflected in regulatory approaches to examinations. One banker proposed that examinations be based on ratings and suggested an extension of the exam cycle to 18 to 24 months for well-managed institutions. If highly rated banks get reviewed less often, examiners will have more time to focus on banks that need more resources and scrutiny.

Small business lending

Community banks' advantages in small business lending include their abilities to make faster decisions, offer longer-term loans with competitive rates and maintain close proximity to borrowers. One banker mentioned how community banks differentiate themselves by offering tailored small-business lending solutions. Another banker's view is that small business loans are the future of community banks because their larger counterparts are not interested in this segment of the market.

Embracing technological advances in banking

Bankers have differing views on the effects of technology. One banker thought that it will provide a greater level of efficiency for banks and their customers. Another viewed it as a threat due to compliance burdens that are not borne equally by fintech companies. Overall, bankers viewed technological innovations as both a threat and an opportunity.

Cyber threats

Bankers acknowledged the significance of the threats facing their institutions. They also recognized that simply having "good" technology is not good enough. One banker noted that education is the key to fighting cyber threats. Others also noted that since people are, at times, the weakest links in cybercrime, educating customers and employees is paramount.

Bankers stated that internal and external audits help to defend against these threats. Given the increased surveillance of cyber threats, banks are allocating more resources to IT and insurance to mitigate any potential losses.



Wyoming

FIVE QUESTIONS FOR FIVE BANKERS | 2018 NATIONAL SURVEY

Future of the community bank business model

Wyoming community bankers believe that the community banking model is changing and that only banks willing to adapt to the new climate will survive. Bankers called for regulatory changes to help make the community banking model sustainable. Even with changes, the bankers conceded that consolidation will continue. One banker went as far to say, “I think there will be a couple thousand less community banks in the next 10 years.” Most bankers attributed the consolidation to the regulatory environment and evolving technological necessities.

Tailoring bank regulation and supervision

Wyoming bankers expressed varying views on efforts needed to improve the identification and monitoring of risks. Some bankers called for more realistic expectations when it comes to examinations. One banker suggested dividing the federal regulatory agencies into two or three subagencies, and another asked for the standardization of platforms used to upload data.

Small business lending

Most of the bankers stated that “knowing your customer” and having good relationships are what set them apart from the competition. Prompt service, fast approval times, flexibility, local decision-making, knowledge and experience were all noted as crucial to setting themselves apart from competitors.

Embracing technological advances in banking

While Wyoming bankers had many different perspectives on technology in banking, they unanimously agreed that it is both an opportunity and a threat. Most bankers want to embrace technology as a way of better connecting with customers, but they are wary of the costs to do so. Further, the fear of an unsuccessful launch of technology is considered a major risk. Training employees and keeping up with trends in technology also have proven challenging.

Cyber threats

Bankers use a rapidly growing and constantly adapting plan of defense against cyber threats. Applying threat detection programs, social engineering, firewalls, on-site and off-site backups of systems, improved security training for employees, quick patching of operating systems, creation of response teams and intensive preparation are all ways to defend banks against cyber threats. All the bankers believed cyber threats are a major problem; one noted stopping 400,000 attempts at breaches in a single month.

