



Community Banking | 2016 in the 21st Century

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Community Banking in the 21st Century

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We are now in the fourth year of an important partnership between the Federal Reserve and the Conference of State Bank Supervisors (CSBS). Our shared goal through this partnership is to develop a better understanding of the challenges and opportunities facing community banks in the aftermath of the financial crisis.

An assessment of the opportunities and challenges would be incomplete without hearing from community bankers themselves. For that reason, the Conference of State Bank Supervisors continued its community bank survey in 2016, with a special emphasis on small business lending, compliance costs, and the changing nature of the products or services offered by community banks. More than 550 bankers responded to this year's survey.

This publication summarizes the findings. One finding is that community banks are wary of the impacts of financial technology, although they have not yet felt dramatic impact. Another suggests that frustrations with regulatory burden, while significant, may be leveling off. Old challenges remain, and new ones emerge.

I am grateful to the CSBS and the state banking commissioners for their effort in conducting this survey. The data gathered through the survey, along with anecdotal information gained through associated "Five Questions for Five Bankers" interviews, inform this publication and promote continued interest by academics, policymakers and regulators in the issues facing community banks.

Jerome H. Powell

Governor

Federal Reserve Board of Governors

Chair, Subcommittee on Smaller Regional and Community Banking

The important role that community banks play has been long understood by those dealing directly with these institutions. However, not everyone has shared this same understanding. In today's world, understanding and relevance are determined through empirical data and analysis, which had been lacking about community banking. Perhaps for this reason, Congress and other policymakers alike did not fully appreciate the importance and dynamic nature of community banking. While this information gap may not have been raised first by those who founded this community bank research and policy conference, the creation of the conference certainly was timely.

This is our fourth *Community Banking in the 21st Century* conference. It is a wonderful partnership between the Conference of State Bank Supervisors (CSBS) and the Federal Reserve. Through surveys jointly developed and distributed by state supervisors to their community banks and through many town hall-style meetings held across our country, information is gathered each year and compiled. Each year, the process has become more refined. General issues that were pointed out in the earlier years become more concentrated later. An example is the concern about home mortgage lending in the first year, which we explored more deeply in later years. Factual issues were evaluated, and concerns brought out. If one banker thinks one thing, that may be interesting, but if hundreds share the same concern, then the issue becomes more relevant.

During these four years, with the importance of community banking becoming more apparent, Congress and regulators have taken steps to begin removing community banks from regulatory regimes intended for larger banks that pose more systemic risk. Indeed, our conference has become part of the policymaking fabric. We attract leading academic research on the current condition and the future of community bank lending. We assemble roundtables for bankers to discuss their issues with one another. Possibly more important, we look ahead to the next generation by encouraging and recognizing research from university students, such as those from Southeastern Louisiana University, the winners of the 2016 CSBS Community Bank Case Study Competition for best research on community banking.

In our survey, we see an outsized role in small business lending; how “soft” information plays an important role in lending decisions; and a continued embrace of mobile and related technologies. At the same time, the survey helps us understand how certain new regulations or their applications have slowed growth in mortgage lending and made other business segments less attractive. These findings, in particular, underscore the need for careful consideration of unintended consequences and the application of right-sized regulation.

To all of the community bankers, I am pleased that we can take up these issues at our conference to help you better serve your communities.

Charles G. Cooper

Commissioner, Texas Department of Banking

Chairman, Conference of State Bank Supervisors

Introduction

Community banking has consolidated in the aftermath of the financial crisis, with fewer banks centering the industry than leaving it through mergers or for other reasons. But the profitability of those remaining has recovered closer to precrisis levels than it has for larger banks. And, perhaps most important, community banks' share of the market for small business loans—the lifeblood of community banking—remains robust and vastly disproportionate to their size.

The Federal Reserve System and the Conference of State Bank Supervisors (CSBS) have been at the forefront of exploring such evolving issues facing community banks. Since 2013, the annual *Community Banking in the 21st Century* research and policy conference has brought together academic experts, federal and state policymakers, and community bankers in a forum focusing on the important role played by community banks in both local markets and the national economy. Embedded in thousands of local communities, community banks are crucial to the economic success of households and businesses across the country.

This year's report on community banking is based, in part, on results of the third annual survey conducted by the CSBS and by state banking regulators. The findings from the survey are supplemented by excerpts from interviews of community bankers that were conducted by state banking commissioners in 29 states. The interviews are referred to as "Five Questions for Five Bankers." The excerpts can be found in the next section of this volume, broken down by state.

Permeating this report is a continued concern of community bankers with regulatory burden. But there are hints of a possible plateau. Relative costs of compliance identified in the survey were about the same as last year. An expansion was seen in mortgage lending, an activity from which some community banks withdrew following new regulations issued after the financial crisis. And concerns expressed by bankers about the regulatory environment appear to be no stronger than those from previous years.

Another important thread interwoven through this year's report is a struggle of community bankers to understand the role of technology in how they serve their customers and, perhaps more pressing, in how they defend themselves against—or possibly embrace—so-called marketplace lenders. These lenders are not perceived to be an overt concern today, as only a fraction of surveyed banks listed them as current competitive forces in lending. But bankers see them as a more significant threat in the future.

A final issue that we explore in this year's report, and to a greater extent than previously, is lending to small businesses and small farms. Our analysis offers insight into the close relationships that community bankers cultivate with these borrowers, to whom they lent \$340 billion last year, an amount that, while slightly lower than in previous years, was nevertheless higher than the amount extended by their larger counterparts.

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Background on the Survey

To develop the survey, staff members of the CSBS met with representatives from several Federal Reserve banks, the Federal Reserve Board of Governors and the academic community. Together, they developed questions, which were refined by the Survey Research Institute (SRI) at Cornell University. The survey was distributed by the state banking regulatory agencies in April 2016.

The questions were intended to address current issues of relevance to the community banking industry. Many of them were asked in previous surveys, thereby offering an opportunity to compare responses over time.

In all, 557 commercial banks and savings and loan associations took the survey. Almost all of these entities—which we will hereafter refer to generically as “banks”—had less than \$10 billion in assets, which is a commonly used threshold for defining community banks.

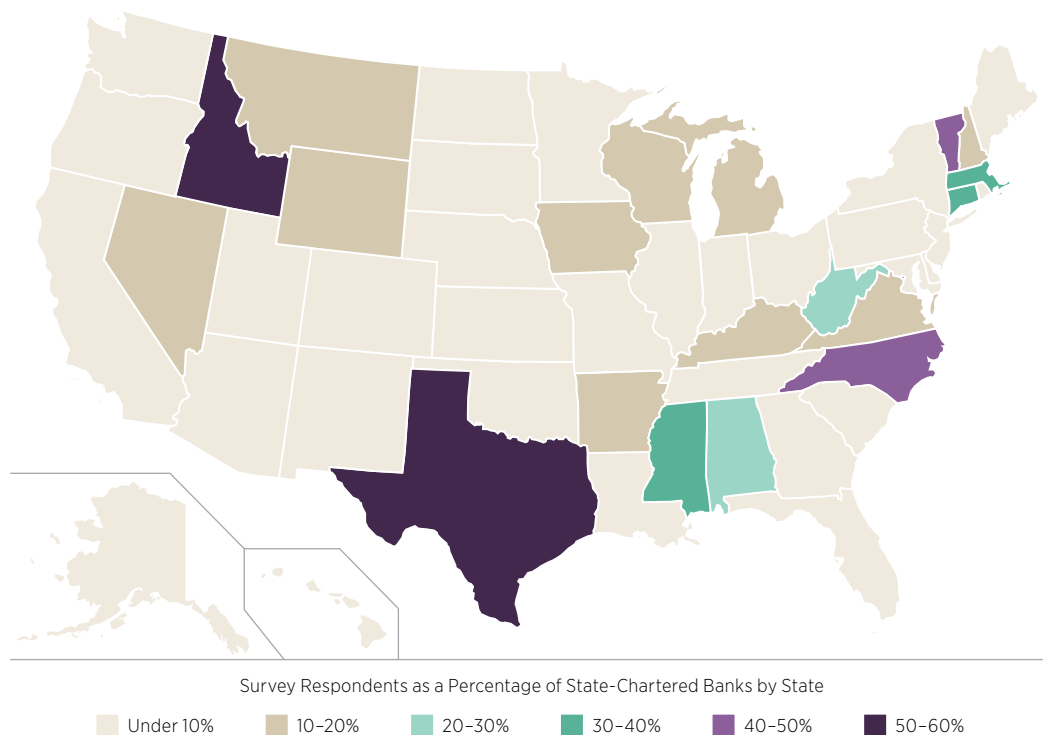
The number of banks in the sample is less than what we had last year. The drop can be attributed, in part, to a change in survey design that made it possible for us to link all respondent banks to their publicly reported financial information. This was done to facilitate a more comprehensive analysis.

Twenty-six states are represented.¹ Figure 1 contains a map showing the state-level participation rates. The unequal geographic

distribution raises potential issues with respect to survey bias—that is, with how representative our respondent banks may be of the community banking industry overall. To address these issues, we compared characteristics of respondent banks with characteristics of all banks for which information is available in the Consolidated Reports of Condition and Income (Call Reports). We limited comparisons to state-chartered banks with less than \$10 billion in assets. (Only a handful of our survey responses came from banks with national charters.)

Tables 1 through 3 provide information on assets, branches and geographic diversification, respectively, for respondent banks and for the industry in general. Banks in the smallest size categories

FIGURE 1
Community Bank Participation by State



that participated in the survey tended to be underrepresented relative to the industry as a whole. In this regard, banks with less than \$50 million in assets represented 6 percent of those in our survey but 11 percent of all community banks (Table 1). Banks that took our survey branched to a greater extent than the overall industry (Table 2) but exhibited similar geographic range (Table 3).

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

Results

The Activities of Community Banks

An important goal of the survey is to describe current conditions in the community banking industry and, perhaps equally important, to use those descriptions as a lens through which the opinions of bankers can be filtered. We begin with an analysis of their activities.

Lending Activities

Lending, of course, is a primary purpose of banks, and community banks are no exception. Compared with their larger counterparts, in fact, community banks tend to have higher ratios of loans to assets and rely to a greater extent on interest revenue to generate income.

Information from the survey on lending activities is presented in Figure 2. It is arrayed by: 1) activities currently

TABLE 1
Bank Asset Size Categories

What was the asset size of your bank as of Dec. 31, 2015?	Banks in Survey		All State-Chartered Community Banks	
	Number	Percent	Number	Percent
Up to \$50 Million	32	5.75%	505	10.85%
\$50 Million to \$100 Million	81	14.54%	805	17.30%
\$100 Million to \$300 Million	216	38.78%	1,792	38.51%
\$300 Million to \$1 Billion	157	28.19%	1,111	23.88%
\$1 Billion to \$2 Billion	37	6.64%	234	5.03%
\$2 Billion to \$10 Billion	30	5.39%	206	4.43%
Greater than \$10 Billion	4	0.72%	0	0.00%

TABLE 2
Branching

How many branches does your institution currently have?	Banks in Survey		All State-Chartered Community Banks	
	Number	Percent	Number	Percent
0 (Headquarters Only)	80	14.36%	957	20.57%
1-5	287	51.53%	2,446	52.57%
6-10	95	17.06%	641	13.78%
More than 10	95	17.06%	609	13.09%

TABLE 3
Geographic Diversification

In how many states does your bank operate?	Banks in Survey		All State-Chartered Community Banks	
	Number	Percent	Number	Percent
1 State	501	89.95%	4,230	90.91%
2 States	37	6.64%	317	6.81%
3 States	9	1.62%	65	1.40%
4 States	3	0.54%	21	0.45%
5 States	3	0.54%	10	0.21%
6 or More States	4	0.72%	10	0.21%

offered that are planned for continuation, 2) activities currently offered that are expected to be substantially curtailed, 3) activities that are not offered currently and are not expected to be offered, and 4) activities that are expected to be offered that are not offered currently.

Lending activities are organized along the following categories: small business loans, real estate construction loans, fixed-rate mortgage loans, small-dollar unsecured loans, credit card loans, automobile loans, home equity

loans, adjustable rate mortgages, loans made through the Small Business Administration (SBA), student loans and reverse mortgages.²

We supplement the analysis of self-described activities with information on surveyed banks obtained from Call Reports and presented in Table 4. Dollar volumes of loans in select categories are measured as of Dec. 31, 2015. Growth rates over the previous calendar year also are indicated.

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Small Business Loans

Small business loans are defined in Call Report instructions as commercial and industrial loans, as well as loans secured by nonfarm, nonresidential properties, that have original amounts of \$1 million or less. Small farm loans are defined as loans secured by farmland, loans to finance agricultural production and other loans to farmers that have original amounts of \$500,000 or less.

But how do bankers define them?

More than one-third of respondent banks, unsurprisingly, defined small business loans on the basis of loan size or revenue of the borrower (Figure 3). It is interesting to note, however, that some bankers did not distinguish between small business loans and commercial loans, of any size, insofar as about one-third of them categorized them identically.

When asked about factors considered in small business lending, community bankers were nearly unanimous in their reliance on financial

statements (Figure 4). Prior to the financial crisis, by contrast, small business lending was based to a greater extent on “simple financial recordkeeping including ... crude accounting and financial management tools.”³ Things apparently have changed; bankers, in verbal comments, frequently cited the important roles played by collateral, cash flow, credit histories, financial statements, credit scores and other quantitative factors.

The nearly 80 percent of all respondents who said they relied on the personal credit scores of business owners (Figure 4) suggests a focus on characteristics of the individuals who manage companies seeking credit as well as those of the companies themselves. In interviews, bankers specifically mentioned previous relationships, assessments of character, experience and reputation—all of which were encapsulated in a comment by one banker that small business lending is based on “what we know about the person(s).”

More than 80 percent of all respondents said that

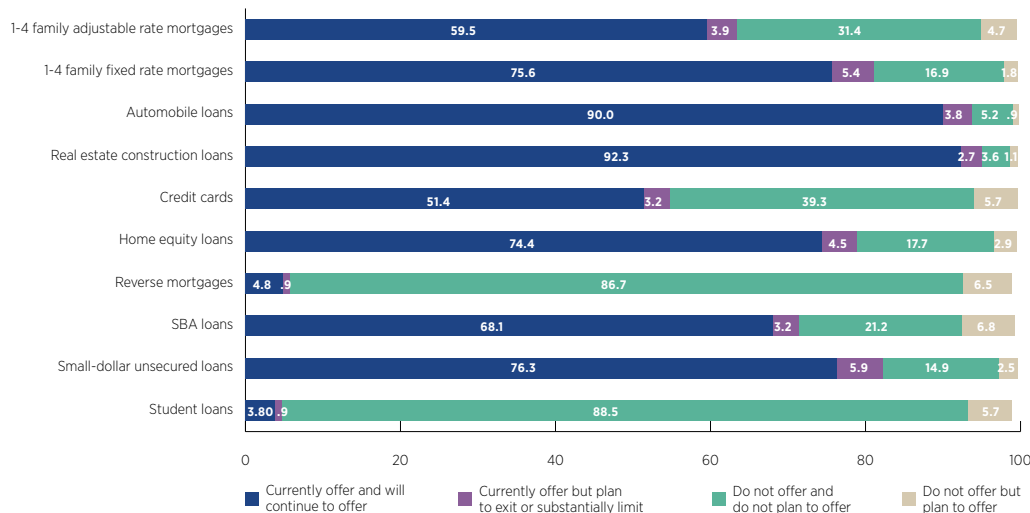
prior relationships with their own bank are important in extending credit (Figure 4). Repeat business creates not only profit on the loans themselves but also potential profit down the road in terms of recovering sunk costs of credit analysis, cross-selling opportunities and opportunities for growth as borrowing companies expand in size or scope.

The tendency of community banks to lend to borrowers they already know is further evident in the 80 percent of surveyed banks that said they had a prior banking relationship with a majority of their borrowers (Figure 5). Such relationships help “to substitute for a prior borrowing history” and “to align the interests of the two parties such that they will treat each other fairly so as not to damage their future relationship.”⁴

Close relationships between businesses and banks also are suggested by the frequency with which community bankers meet with, provide advice to or otherwise monitor small business borrowers (Figure 6).⁵ Respondents said they met at least quarterly with nearly half of their small business borrowers and on a weekly basis with nearly 3 percent of them. Frequent meetings underscore the comment of one banker, who said that “our clients benefit from us being able to listen to them and customize services to meet their needs.”

More than half of all bankers, on the other hand, said they met with their borrowers at intervals of one year or more. Small business relationships, apparently, are not always time and labor intensive.

FIGURE 2
Lending Activities



Small business loans increased by more than 7 percent in 2015 (Table 4). Growth was faster for small farm loans, which is consistent with a 9 percent increase in agricultural lending across the community banking industry in an overlapping period.⁶ This growth was driven, perhaps, by increased needs for credit within a contracting sector as farmers and ranchers sought to offset declines in net farm income, which dropped by 38 percent in 2015.⁷ In this regard, Kansas bankers said they have noticed that, while their agricultural-based customers have struggled to meet financial obligations as disposable income has diminished, the overall agriculture industry remains healthy.

Last year's change in small business and small farm lending by surveyed community banks can be understood in the context of industrywide changes since the financial crisis, which are presented in Table 5. The table lists the number of small business loans, the dollar amount of small business loans and the ratio of small business loans to total loans for community banks (with less than \$10 billion in assets) and, separately, for other banks (with more than \$10 billion in assets). The values are industrywide totals calculated at the end of each calendar year.

The dollar amount of small business loans, across both categories of banks, has declined slightly since the crisis, from \$555 billion in 2010 to \$545 billion in 2015. Small farm loans increased, from \$67 billion to \$72 billion, of which \$65 billion was held by banks with less than \$10 billion in assets.

Community banks have lost ground to other banks in small business lending. From 2010 to 2015, small business loans for banks with assets less than \$10 billion declined by 7 percent while the same loans for banks with assets greater than \$10 billion increased by 4 percent; by the end of this period, loan volumes across the two categories of banks were roughly equivalent. Because of the dominance of smaller banks in small farm lending, however, the dollar volume of overall lending by community banks, \$340 billion, comfortably exceeded the dollar volume made by their larger counterparts, \$277 billion.

The importance of small business lending to community banks is reflected in their prominence within loan portfolios. Of all loans in 2015, small business loans represented 17 percent, and small farm loans represented 4 percent. The same percentages for larger banks were, respectively, 4 percent and less than 1 percent.

The average balance of small business loans made by community banks in 2015 was \$96,000. The average balance for larger banks was much less, \$17,000. This is consistent with an erosion of market share for community banks in loans with smaller denominations. These loans typically are underwritten on the basis of credit scores, which larger banks can process more efficiently using economies of scale.

Larger loans, on the other hand, generally are not underwritten solely on the basis of credit scores because lenders are not willing to incur the risk

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FIGURE 3
Bankers' Definitions of Small Business Loans

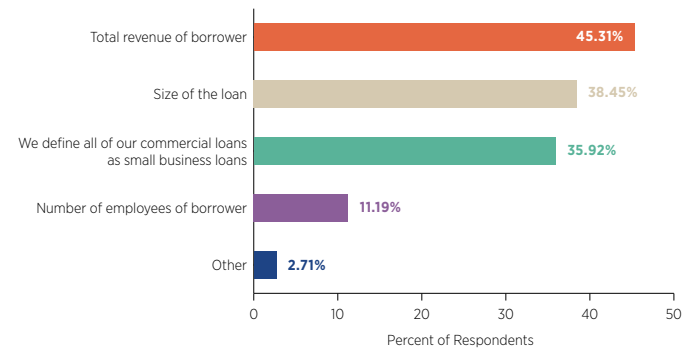


FIGURE 4
Factors in Small Business Lending

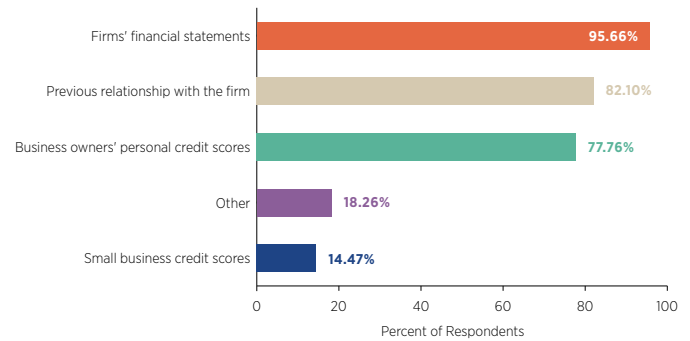
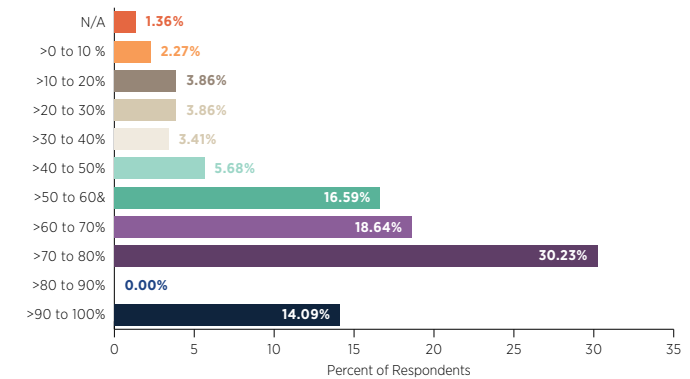


FIGURE 5
Percentages of Borrowers with Prior Bank Relationships



associated with them without the benefit of a traditional underwriting approach. For borrowers seeking these loans, community banks are often the lender of choice; the local knowledge of community bankers and their close ties to the communities they serve enable them “to establish a deep understanding of local businesses that allows them to prudently provide credit to borrowers who might not otherwise be considered credit-worthy.”⁸

An important component of small business lending occurs under the SBA. Such lending was named by 68 percent of community bankers as a product they offered and planned to continue to offer (Figure 2), which was high relative to the 24 percent of bankers who named it as a primary product

line in last year’s survey. To reach this market, community banks have hired more lenders, added new product lines or acquired SBA lenders, possibly in response to efforts by the SBA to improve its lending platforms.⁹ These trends are underscored by the plans of community banks (Figure 2); 7 percent of surveyed banks said they intended to enter the market, while only 3 percent said they planned to exit.

Real Estate Construction Loans

Construction loans were named by more than 90 percent of respondent banks as a product that they currently offer and plan to offer in the future (Figure 2).¹⁰ They constituted about 7 percent of community bank loan portfolios and grew last year by nearly 21 percent (Table

4). The latter was high relative to other categories among surveyed banks and reflected industrywide growth for an overlapping period of nearly 16 percent. (See FDIC.)

Rapid growth in construction lending has led to worries about an emerging bubble. One banker from Utah said that “it appears as though the price of land is getting back to 2006-2007 levels and is not sustainable.” Other bankers said that requests by builders for speculative financing are increasing significantly.

Perhaps because of the large existing community bank presence in construction lending, only 1 percent of banks that currently do not offer such loans plan on doing so in the future (Figure 2). On the other hand, only 3 percent of banks that currently offer construction loans plan to substantially curtail their involvement, which is low relative to many other categories (Figure 2). This pattern may extend from different emphases on an expected deterioration in loan performance for multifamily residential properties or, alternatively, rates of nonperforming loans for construction lending that are less than half the rates for all real estate loans.¹¹

It is important to recognize that the percentages of banks planning to add, or to curtail, lending is very small for many loan products observed in Figure 2. Generalizations based on such limited numbers of banker responses must be qualified accordingly.

Mortgage Loans

Mortgages are a prominent activity among surveyed banks, with 1-4 family fixed-rate

FIGURE 6
Frequency of Contacts with Borrowers

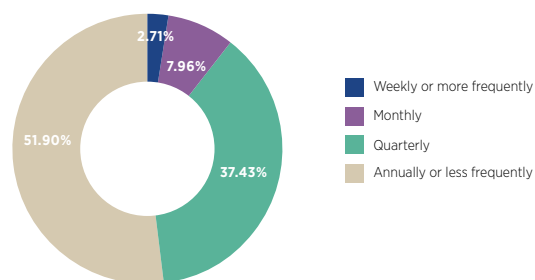


TABLE 4
Loan Portfolios of Surveyed Banks

	Dollar Volume	Percent of Total Loans	Growth in 2015
Small Business			
Commercial	\$50 billion	13.25%	7.12%
Farm	\$7 billion	1.79%	8.84%
Real Estate Construction	\$26 billion	6.94%	20.66%
1-4 Family, Fixed-Rate Mortgages	\$91 billion	24.11%	6.52%
Consumer	\$23 billion	6.17%	4.28%
Credit Card Component	\$2 billion	0.59%	1.14%
Automobile Component	\$10 billion	2.73%	-4.16%

TABLE 5

Small Business and Small Farm Loans

	Less than \$10 Billion in Assets						More than \$10 Billion in Assets					
	Loans to Businesses			Loans to Farms			Loans to Businesses			Loans to Farms		
	No. of Loans	Amount	% of Total	No. of Loans	Amount	% of Total	No. of Loans	Amount	% of Total	No. of Loans	Amount	% of Total
2015	2.86	\$275	16.6	.874	\$65	3.9	15.48	\$270	4.2	.112	\$7	0.1
2014	2.82	\$275	17.5	.901	\$63	4.0	14.77	\$255	4.3	.101	\$6	0.1
2013	2.75	\$273	18.6	.903	\$61	4.2	14.67	\$248	4.4	.092	\$6	0.1
2012	2.94	\$276	19.4	.901	\$60	4.2	13.96	\$248	4.5	.092	\$5	0.1
2011	3.07	\$282	20.2	.945	\$59	4.2	14.05	\$248	4.8	.105	\$6	0.1
2010	3.15	\$295	20.6	1.02	\$61	4.2	13.42	\$260	5.1	.126	\$6	0.1

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

loans named by 76 percent of respondents as a product currently offered that would continue to be offered (Figure 2). It is heavily weighted, accounting for 24 percent of all lending among surveyed community banks (Table 4).

Home equity lines of credit and adjustable rate mortgages also were important components of offered products, at 74 percent and 59 percent, respectively. Both were higher than what was reported in the survey from a year earlier. But they are not heavily weighted; home equity lines of credit, for instance, constituted only about 3 percent of the loan portfolios of all community banks measured earlier this year. (See FDIC.)

Mortgage lending grew by more than 6 percent for community banks in our survey (Table 4), which was somewhat higher than the comparable growth rate for all community banks over an overlapping period. (See FDIC.) It was also higher than the comparable rate across the entire industry. Over a more-extended period, from December 2013 to March 2016, growth in 1-4 family residential lending

at community banks totaled 7 percent versus 5 percent at larger banks.¹²

Observed increases in mortgage lending may be short-lived. In this regard, the percentages of respondent banks that offer, but plan to discontinue, 1-4 family fixed-rate loans and home equity lines of credit were at, or approached, 5 percent (Figure 2), while the percentages of respondent banks that currently do not offer, but plan to offer, 1-4 family fixed-rate loans and home equity lines of credit were 2 percent and 3 percent, respectively (Figure 2). Thus, more banks are planning to exit than enter these areas. This may reflect a weaker demand across most categories of home-purchase loans than was observed late last year.¹³

Exit plans also extend from restrictions on qualified mortgage (QM) and ability to repay (ATR) rules under which bankers continue to chafe.¹⁴ This is reflected in a panoply of banker criticisms: the rules do not “take into account us knowing our customer”; they “just make it tough for a small community bank to have the expertise to do mortgage

loans in a small rural town”; they generate “twice as much paperwork as a \$20 million commercial real estate loan”; and they cause “longer processing times, increased training of personnel and huge software changes to our vendors.”

Although mortgage rules remain a thorn in the side of the community banking industry, at least some community bankers have seen progress. “With regards to QM and ATR, the Consumer Financial Protection Bureau (CFPB) has finally carved out exemptions for small banks in some rural areas,” one banker said.¹⁵

A diversity of opinion regarding non-QM mortgage lending is reflected in lending shares (Figure 7). More than 25 percent of banks reported zero exposure to non-QM loans, while more than 8 percent reported exposures of more than 90 percent of their portfolios. This is similar to what was reported in the previous year’s survey. It is worthwhile to note, however, that the percentages of banks in the largest exposure categories increased.

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Other Loans

Automobile loans were offered, with plans for continuation, by 90 percent of surveyed banks (Figure 2). Relatively few customers accepted these offers, however, as loans in this category constituted less than 3 percent of their total loans at the end of 2015 (Table 4). This level was lower than what was observed at the end of 2014. The decline may reflect increasing competition from finance companies and credit unions, at which growth in automobile loans late last year exceeded, by a considerable amount, growth at banks.¹⁶

Small-dollar unsecured loans were offered, with plans for continuation, by 76 percent of community banks, while credit cards were offered by more than half of them (Figure 2). These large percentages represent relatively modest dollar amounts; credit card lending, in particular, accounted for less than 1 percent of the loan portfolios of community banks (Table 4). Nearly 40 percent of all

surveyed banks said they did not offer credit cards and had no plans to do so (Figure 2).

The extension of small-dollar unsecured credit by community banks has been influenced by marketplace lenders, which use data-driven online platforms and investment capital to lend to consumers. In response, some community banks are establishing collaborative arrangements outside the traditional consumer credit model, such as with BancAlliance, that enable them to mimic the economies of scale wielded by larger banks.¹⁷

The more-inclusive category of consumer loans constituted about 6 percent of the loans of surveyed community banks (Table 4). These loans grew by 4 percent in 2015, which is lower than what was reported for an overlapping period across the entire banking industry. (See FDIC.) But any expansion, however modest, is noteworthy; as recently as 1990, community banks controlled nearly 80 percent of the consumer loan market. By last year, that share had dropped to 8 percent.¹⁸

What this portends for the future of consumer lending by community banks is difficult to discern (Figure 2). More banks said they intended to enter, rather than exit, the market for credit cards (6 percent versus 3 percent); by contrast, more banks said they intended to exit, rather than enter, the market for small-dollar unsecured loans (6 percent versus 3 percent). The foregoing suggests fragmented responses of community banks to the opportunities and challenges presented by new banking technologies. It

could also reflect uncertainty surrounding the CFPB's proposed rule on payday, vehicle title and certain high-cost installment loans as banks ascertain the extent to which the new rules, ostensibly aimed at nonbank lenders, will impact them and their current or prospective small-dollar loan product offerings.¹⁹

Very few respondent banks indicated that they offered student loans or reverse mortgages (Figure 2). The scarcity of offerings for these services was not particularly surprising insofar as they ranked first and second in last year's survey in the categories that bankers planned to continue to avoid in the future.

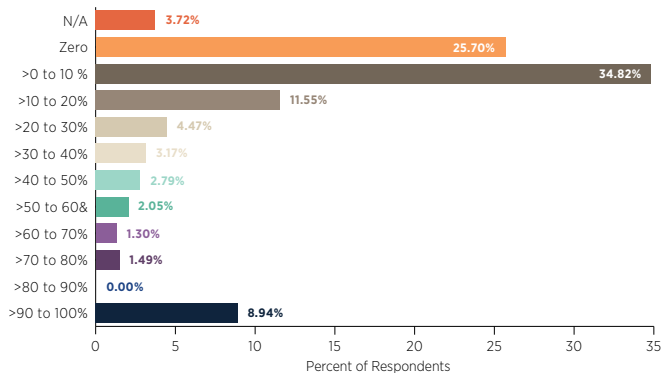
Nonlending Activities

Community bankers are keenly aware of changes in the delivery of products and services, aside from loans, that have evolved outside their traditional roles. Their apprehension was aptly described by one banker in terms of simultaneous races: one to stay ahead of competitors and another to stay within reach of customers.

Information from the survey on nonlending activities is presented in Figure 8. It is arrayed, once again, by category: 1) activities currently offered that are planned for continuation; 2) activities currently offered that are expected to be substantially curtailed; 3) activities that are not offered currently and are not expected to be offered; and 4) activities that are expected to be offered that are not offered currently.

The most commonly offered service, by 88 percent of surveyed banks, was electronic

FIGURE 7
Percentage of Loans That Would Not Have Qualified under the Qualified Mortgage (QM) Standard



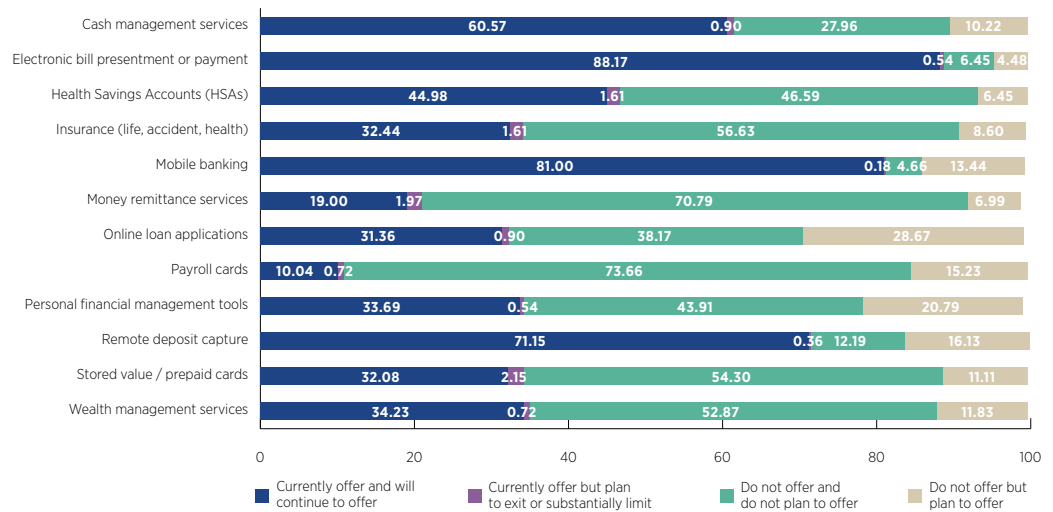
bill presentment or payment (Figure 8). This was an increase from last year's survey, when 76 percent offered the same service.

Mobile banking services were offered by 81 percent of surveyed banks (Figure 8), up from the 71 percent of respondents who offered these services in the prior year. This was anticipated: In last year's survey, 19 percent of bankers said they expected to introduce mobile banking services within the next three years. Growth follows the proliferation of smartphones and other electronic devices, as well as a greater availability of high-speed internet services.

The trend appears likely to continue, as 13 percent of respondent banks that do not currently offer mobile banking services said they planned to do so in the future while only a scant percentage of banks that currently offered such services planned to discontinue them (Figure 8). Expansion would help community banks catch up with their larger counterparts, which have customer utilization rates that are more than three times higher. Catching up may be difficult, however, because community banks are still "trying to master basic mobile banking."²⁰ One banker in Indiana, for instance, said millennials want "all interaction to be via a mobile platform, and this is difficult to implement for small and mid-size banks due to cost and expertise."

Stability, on the other hand, was evident in other areas, including remote deposit capture (71 percent), cash management (61 percent) and personal finance

FIGURE 8
Nonlending Activities



(34 percent). In each of these categories, offerings were at levels similar to those reported in the previous year's survey. That may change: Remote deposit capture and personal finance were rated among the most likely areas of expansion (Figure 8).

About one-third of surveyed banks offered online loan applications; almost all of these banks said they would continue to do so (Figure 8). In last year's survey, 32 percent of banks said they offered such services and 27 percent said they intended to introduce them within the next three years; obviously, not all community banks followed through immediately. Despite this, 29 percent of them still planned to forge ahead (Figure 8).

The stalled level of online lending activity observed this year may reflect technological constraints, which one banker said were predicated on "whether we feel we have, or will gain, the expertise to support (them)." The Office of the Comptroller

of the Currency (OCC) also has expressed concerns with "innovative products, services and processes" that are evolving in response to the entrance of new competitors, such as out-of-market banks and financial technology firms.²¹

Increased offerings for mobile and electronic banking, along with planned expansions in mobile banking and online lending, suggest more spending on technology. But this is not borne out in our survey; technological expenses, while substantial in some cases—31 percent of respondent banks indicated that they represented an expense equivalent to more than 0.15 percent of total assets—were nearly identical to the levels reported in the previous year's survey (Figure 9).

The leveling of technological expenses suggests that community bankers do not necessarily see technology as an ever more encompassing solution to operational problems. This can be inferred from the comment of one

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FIGURE 9
Technology Expenses as a Percentage of Total Assets

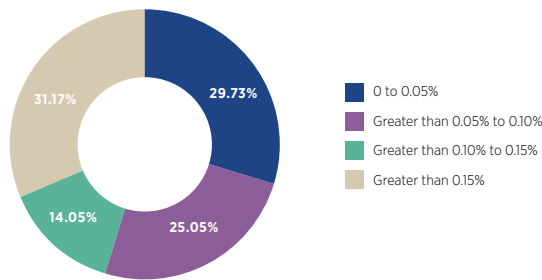


FIGURE 10
Reasons for Exiting an Activity

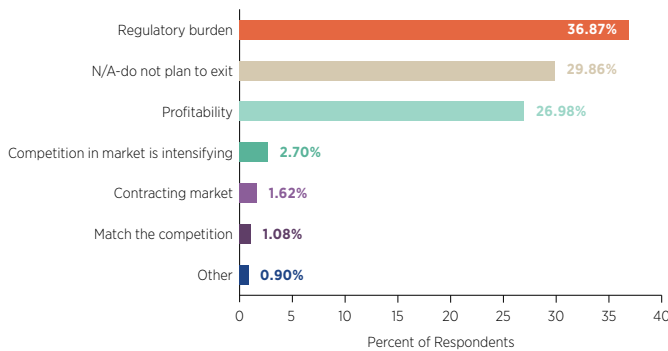
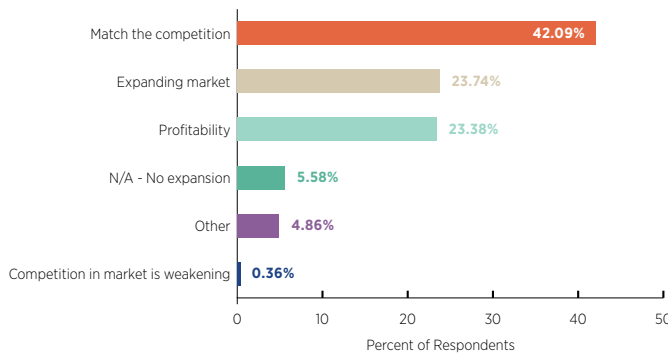


FIGURE 11
Reasons for Expanding an Activity



banker, who said: “I sat down with my compliance officer about a year ago and went through our entire oversight process. We have it highly automated and feel as though we have extracted every ounce of technological efficiency from that process.”

Health Savings Accounts (HSAs) were offered, with plans for continuation, by 45 percent of bank respondents (Figure 8). This was up slightly from the last survey and is consistent with plans for expansion that were identified at that time, when more than 7 percent of banks that did not offer these products said they would in the future.

Few banks offered payroll cards, but many more said they intended to in the future (Figure 8). These cards are used by employees without checking accounts.

Reasons for Adding or Curtailing Activities

Bankers were asked to identify reasons for expanding or exiting their identified activities, in both lending and nonlending areas. Regulatory burden, perhaps unsurprisingly, was named by 37 percent of respondent community banks as a rationale for exiting a specific product or service—a larger percentage than that for unprofitability (Figure 10). One banker described “not being able to offer ‘community bank’ type offerings to commercial customers and potential new homeowners” because “the constant changing of the rules is ridiculous for a (small) bank to comply with.”

Expansions, on the other hand, were driven by the actions of others (Figure

11), as 42 percent of community banks said they were attempting to match what the competition was doing. This percentage is nearly double the percentage that respondents ascribed to market expansion (24 percent) or profitability (23 percent). These numbers appear to suggest a defensive posture; some bankers said that “out-of-state entities,” credit unions and the Farm Credit System were soliciting their customers.

The analysis of the plans of community banks to exit from currently offered activities, across both lending and nonlending activities (Figures 2 and 8), and the reasons for doing so (Figure 10) may overstate incentives to alter product offerings. That is, the bulk of community banks plan to continue in their traditional roles. As was summarized in interviews of Mississippi bankers:

“Community bankers will continue to provide banking services regardless of current regulatory requirements, competitive pressures and changes in the dynamic of the banking industry. The actions and involvement of community banks both stimulate and stabilize the economy of each area they serve. As intentional community advocates, community banks provide not only financial services, but in some cases, life skills to members of the community. In summation, one banker stated that ‘We are ‘all in’ and the same cannot be said for large regional banks.”

Regulatory Compliance

As in the past, we asked bankers this year to identify how much money was spent

last year in five categories of noninterest expenses: personnel expenses, data processing expenses, legal expenses, accounting and auditing expenses, and consulting and advisory expenses. Within a given category, they specified amounts spent specifically on compliance. The intent was to illustrate regulatory burden relative to various categories of operating expense. This information is presented in Table 6.

Surveyed banks stated that regulatory compliance accounted for 11 percent of personnel expenses, 18 percent of data processing expenses, 21 percent of legal expenses, 42 percent of accounting and auditing expenses, and 43 percent of consulting expenses (Table 6). Multiplying the ratios of compliance costs to total costs, for our surveyed banks and within each category, by the total costs aggregated across all community banks creates an implied estimate of potential compliance costs for the industry: \$4.6 billion.^{22,23}

Community bankers often described these costs as “high,” which is unsurprising as well as incontrovertible given the ambiguity of that descriptor. One banker said, “It feels like we are a compliance shop that writes a loan every once in a while.”

Perhaps more interesting, however, are the expressed opinions of at least some community bankers that compliance costs are “increasing.” Are they?

Last year, the same percentages were 11 percent of personnel expenses, 16 percent of data processing expenses, 20 percent of legal expenses,

38 percent of accounting expenses, and 48 percent of consulting expenses. Subtracting the compliance expense ratios reported last year from those reported this year yields differences by categories, respectively, of 0 percent, 2 percent, 0 percent, 5 percent and -5 percent. Regulatory expenses as percentages of noninterest expenses, summed across all categories, were equivalent to what was reported last year.

It seems reasonable to conclude that, although regulatory burden is substantial, it is not necessarily increasing dramatically. The difference between expressed opinions of community bankers and survey findings may be that bankers were thinking in terms of increases in absolute dollar costs rather than costs measured relative to noninterest expenses. Or it may be that they are concerned with implicit factors that extend beyond explicit dollar amounts; in this regard, a banker from Virginia said: “One of the fundamental features of a community bank is our ability to work with customers and determine a reasonable approach to meet their credit needs. Regulation continues to hinder our ability to take a practical approach in many situations.”

To supplement our analysis of the levels of compliance expenses, we sought to identify the specific regulations to which those expenses could be attributed (Figure 12). The most costly regulations were those governing lending activities and were grouped together under the Real Estate Settlement Procedures Act (RESPA), the Truth in

TABLE 6
Compliance Costs as a Percentage of Noninterest Expense by Category

Expense Type	Mean	Median
Personnel (Salary and Benefits)	11.40%	7.51%
Data Processing	17.63%	12.89%
Legal Expenses	20.68%	12.82%
Accounting and Auditing	41.50%	35.29%
Consulting and Advisory	42.64%	34.33%

Lending Act (TILA), the TILA-RESPA Integrated Disclosure Form (TRID) and Regulation Z (collectively referred to hereafter as “RESPA and TILA”). More than 23 percent of compliance expenses identified by surveyed community banks were related to these regulations.

The RESPA and TILA regulations, in addition to being the most costly, were also identified by surveyed bankers as the most confusing to administer (Figure 13).²⁴ Among the complaints against RESPA and TILA is a tendency for them to prolong the lending process (Figure 14): Nearly 45 percent of bankers said they either “slowed the pace of business” or “delayed closings.” Frustration is reflected in the comment of one banker who said, because of these regulations, “Only one person in the bank knows how to close a loan.”

For some bankers, the regulations are the result of good intentions gone awry. The idea, one banker said, “was to protect the consumer from unscrupulous lenders, outrageous fees, unnecessary documentation and to make the forms easier to understand.” But the outcome was “increased confusion” for

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FIGURE 12
Percentages of Compliance Expenses and Specific Regulations

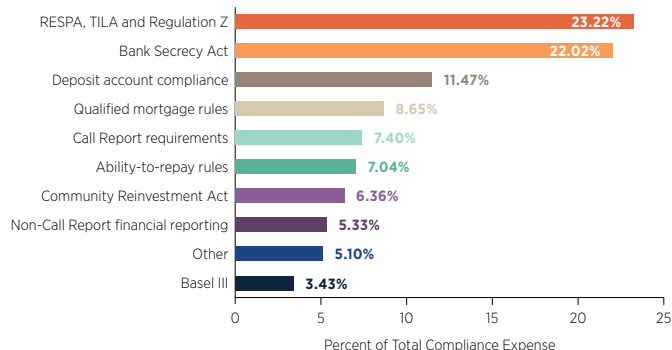
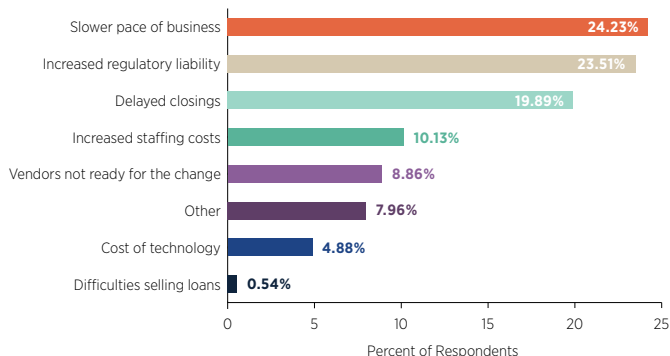


FIGURE 14
Concerns with RESPA and TILA



consumers and a reduction in the types of loans available to them.

“We are currently working on a \$60,000 lot loan,” another banker said. “Trying to get the early disclosures out to comply with [RESPA and TILA] required one loan processor to spend over six hours preparing documents and getting outside vendor fee commitments. Not sure how long we will be able to keep employees doing this type of work.”

The frustrations of community bankers with RESPA and TILA are further underscored by the regulations’ notoriety; in this regard, nearly half of all respondents named them as regulations, laws or

FIGURE 13
Most Confusing Regulations

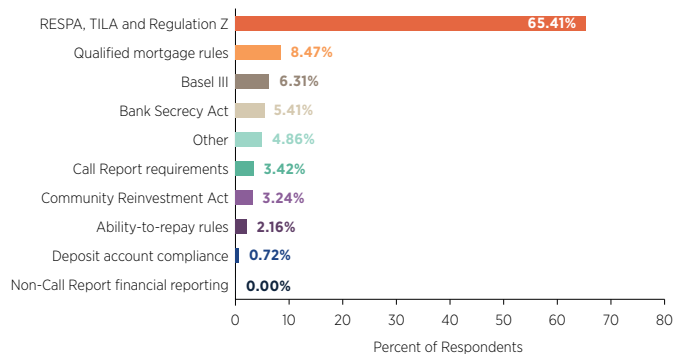
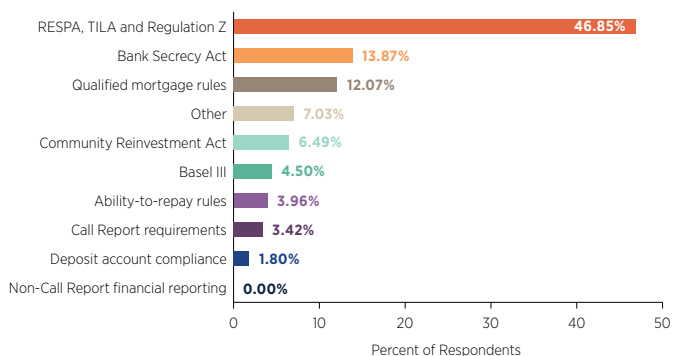


FIGURE 15
What Regulation Would You Change if You Could?



reporting requirements that they would change if they could (Figure 15).

The Bank Secrecy Act (BSA), along with associated anti-money-laundering provisions, was named as the most costly regulation by 22 percent of respondent banks (Figure 12). Bankers object, particularly, to what they consider a requisitioning of them by law enforcement. One banker said that acting like “detectives” is not in the skill set of bankers “nor what they were hired to do.” Another banker said BSA demands significant resources and is “a drag on earnings, morale and the focus of the bank on serving customers and the community.” Another

was frustrated by the “exponential growth” of reports on suspicious activities without commensurate growth in “terrorists caught.”

Not all regulations, however, were perceived as onerous; the Community Reinvestment Act and Basel III regulations, for instance, constituted relatively small percentages of compliance expenses (Figure 12). Financial reporting requirements associated with the Call Report also represented a relatively modest cost (7 percent of compliance expenses) but were noticeable nevertheless:

“I look at what it takes us to file a Call Report today and I shudder,” one banker said. “In

1950, the Call Report for a bank encompassed four pages and 53 reported items. Today, the Call Report encompasses 84 pages and 2,379 reported items.”

Such opinions presumably played a role in a planned streamlining of these requirements for community banks that was announced by financial regulators Aug. 5, 2016. The regulations, which are scheduled to take effect by March 31, 2017, would reduce by 40 percent the number of data items reported by banks with assets less than \$1 billion.²⁵ These changes have been praised by several banking associations as “commendable” and “the right answer” for addressing regulatory burden.

Community bankers, without a doubt, remain painfully aware of regulatory costs, particularly those associated with expanded purviews of existing regulation. And it is speculative, of course, to make sweeping conclusions about changes in what bankers across the country are thinking from the opinions gleaned from a small sample of them in our surveys and interviews.

But the stability of compliance costs identified in this survey and its predecessor, along with the expansion of mortgage lending, may be telling. Both comport with interviews in which some bankers expressed a perhaps grudging acceptance of the compliance costs that they have already incurred and also, to a lesser extent, of costs that may be incurred in the future. Some bankers in Wisconsin, for instance, pledged to incur additional compliance costs as necessary to offer products

or services that are “right” for their markets and customers.

Market Structure

The structure of the market in which community banks operate affects, and is affected by, changes in competition and patterns of consolidation. Both are influenced by profit expectations.

One current perspective on profitability is optimistic, as community banks “have posted a strong recovery in the postcrisis period that has, in several respects, outpaced the recovery at larger institutions.”²⁶ Another perspective is sensitive to the notion that community banks are facing “increased competition for loans, as well as regulatory and technology costs, and low interest rates that are crimping profitability.”²⁷

Competition

We asked bankers to characterize competition that they face currently, as well as competition they expect to face in the future, in small business lending, consumer lending, agricultural lending, mortgages, deposits and payments.

Small Business Lending

In small business lending, the most intense competition for community banks, by far, was said to be from ... other community banks (Figure 16). They were named as the toughest competitor by 65 percent of bank respondents with respect to current competition and by more than half of respondents with respect to future competition (Figure 17). This dwarfed the next most highly ranked competitor, regional banks, which were named by less than 17

FIGURE 16
Single Greatest Source of Current Competitive Pressure, Small Business Lending

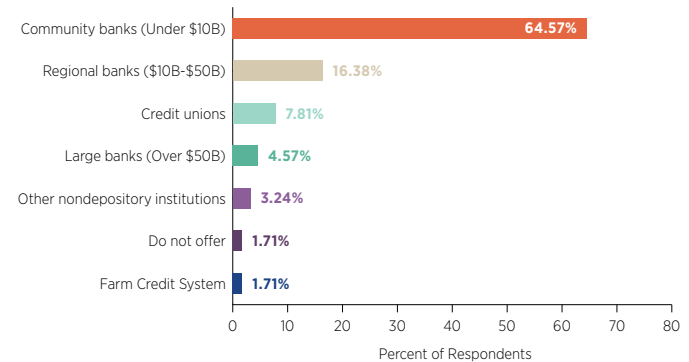
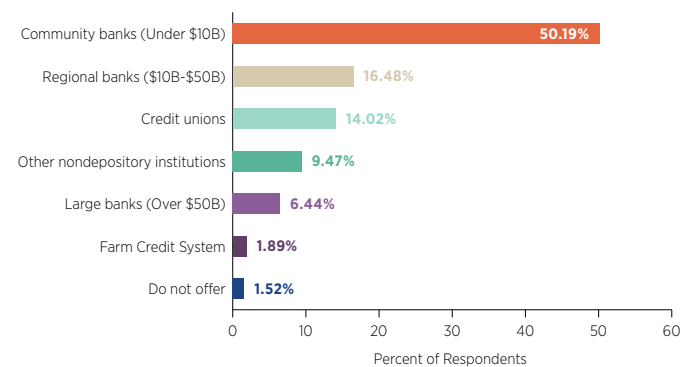


FIGURE 17
Single Greatest Source of Future Competitive Pressure, Small Business Lending



percent of respondent banks in both cases.

Competition in small business lending from “other nondepository institutions” presumably incorporates marketplace lending by financial technology, or “fintech,” companies. These are active in the one-quarter of the market for small business loans that is held by nonbanks.²⁸ But they are not perceived as a current threat, as only 3 percent of banks listed them as competitive forces for small business lending (Figure 16).

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A complacent attitude toward fintech may reflect recent collaborations with erstwhile competitors; for example, community banks and other related lenders “snapped up” about 34 percent of the \$2.8 billion in loans arranged by Lending Club in the first quarter of 2016.²⁹ This attitude may also reflect recent challenges faced by some marketplace lenders in managing costs, credit performance and loan delivery. Both underscore a “wait and see” attitude expressed by some surveyed banks:

“Bankers have not witnessed much competition from financial technology companies

within the small business lending space,” interviews of bankers in Kansas revealed. Bankers in Missouri said that “though there is some competition from online lenders, their impact is hard to measure.” Bankers in Idaho were said to be “optimistic about their ability to compete with online lenders.”

With respect to future competition, however, the threat level triples, to more than 9 percent (Figure 17). This is consistent with an online industry that is growing rapidly, but from a small base; marketplace lending for small business loans has been estimated to have increased from

less than \$1 billion in 2010 to over \$4 billion in 2014.³⁰ That \$4 billion, however, represented only about 2 percent of small business loan issuance nationwide.

Despite the influx of competitors, and from so many different angles, community banks remain confident in their ability to lend within the small business sector. As one banker in Idaho said, “Community banks still have an advantage given the relationships they have built with their customers.”

Other Lending

In consumer lending, competition exerted by

FIGURE 18
Single Greatest Source of Current Competitive Pressure, Consumer Loans

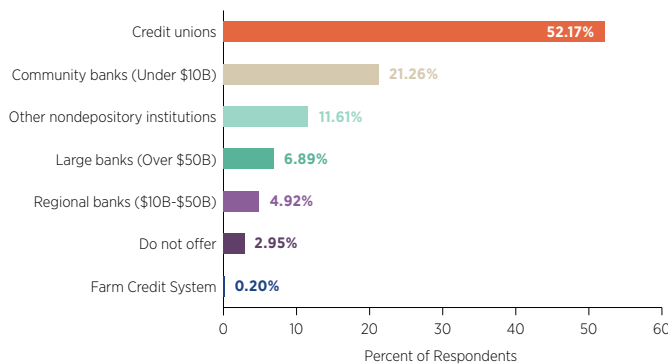


FIGURE 19
Single Greatest Source of Future Competitive Pressure, Consumer Loans

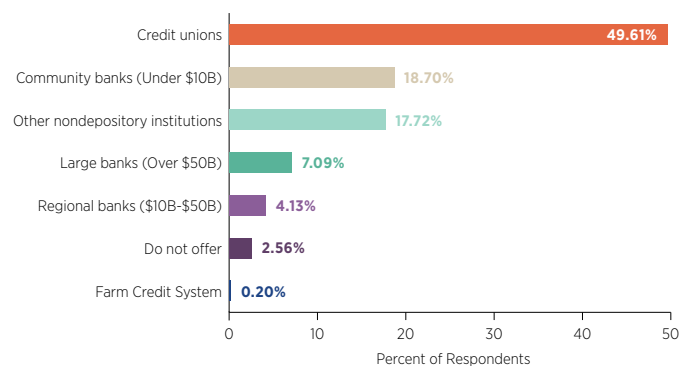


FIGURE 20
Single Greatest Source of Current Competitive Pressure, Agricultural Loans

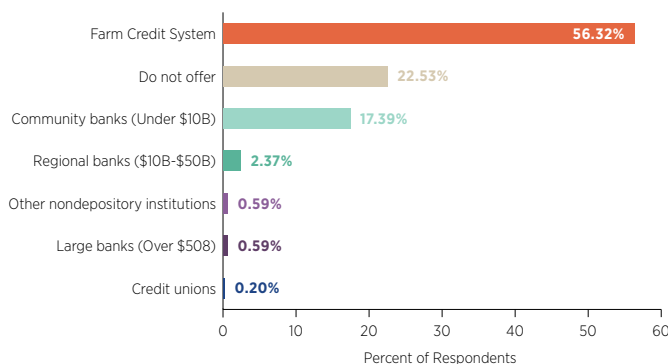
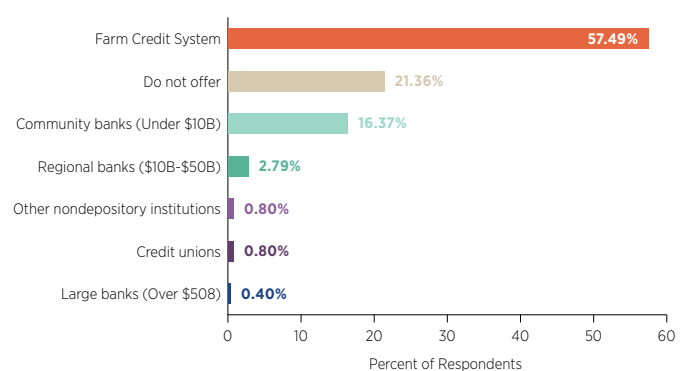


FIGURE 21
Single Greatest Source of Future Competitive Pressure, Agricultural Loans



marketplace lenders is more significant, as 12 percent of surveyed bankers said other nondepository institutions were a current threat (Figure 18). This increases to 18 percent with respect to future competition (Figure 19). The latter may reflect a growing recognition that online lending is able to fill a need for some consumer borrowers by delivering lower costs and faster decision times than traditional lenders.³¹

The toughest competitors for consumer loans were credit unions, which were named by about half of all surveyed bankers for both current and future competition. As was the case in the previous year's survey, the threat from credit unions is often described as arising from their inherent tax advantages and what is perceived to be a more lenient regulatory environment. This year, however, the ire of community bankers has been raised further by new rules proposed by the National Credit Union Administration to boost credit union membership.³² The rules would extend limits on "fields of membership," giving them more flexibility to expand.

"We continue to be frustrated by the lack of a level playing field in regard to credit unions," one banker said. "They continue to increase their product offerings outside their primary charter and into the market of community banks without bearing the same regulatory scrutiny and financial tax burdens."

Competition in the market for agricultural lending is dominated by the Farm Credit System, which was named as a current competitor, and one

expected to be in the future, by more than half of respondents (Figures 20 and 21). Because of what was perceived to be "unfair competition," one banker in Mississippi said that community banks "simply cannot compete."

Competition for mortgages was relatively dispersed (Figures 22 and 23). Surveyed bankers cited the current, and expected, presence of community banks and large banks, regional banks and credit unions. The largest threat, however, came from other nondepository institutions, at 27 percent currently and 32 percent in the future. It presumably is being exerted by online loan originators, such as Quicken Loans, which recently has been responsible for as much as 7 percent of the nation's mortgage loans.³³

Other Nonlending Activities

Shifting to the liability side of bank balance sheets, the responses of surveyed banks suggest a shift in competition for deposits (Figures 24 and 25). Current competitors are dominated by community banks (named by 48 percent of respondents) and, to a lesser extent, credit unions (25 percent), large banks (14 percent) and regional banks (11 percent). In the future, however, expected competition from community banks diminishes (38 percent), supplanted by increases at credit unions (28 percent) and, significantly, other nondepository institutions (6 percent).

On payments, competition currently is felt mainly from large banks, at 29 percent (Figure 26). Also prominent are other nondepository

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FIGURE 22
Single Greatest Source of Current Competitive Pressure, Mortgages

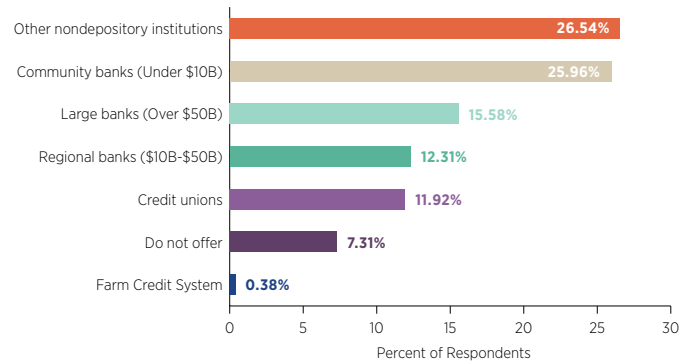
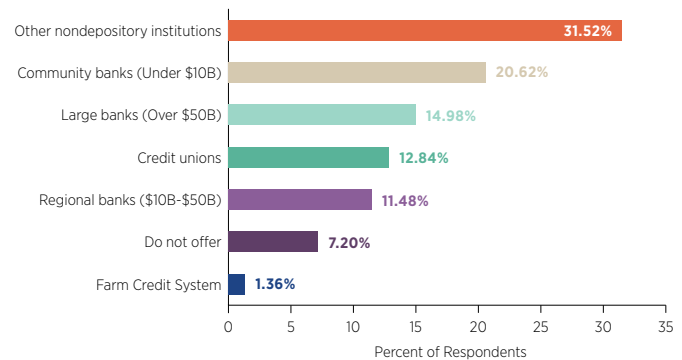


FIGURE 23
Single Greatest Source of Future Competitive Pressure, Mortgages



The ire of community bankers has been raised further by new rules proposed by the National Credit Union Administration to boost credit union membership.

institutions, at 19 percent. Competition from the latter is expected to increase; 26 percent of respondent bankers anticipate that they will be a competitive force in the future (Figure 27). This is consistent with a belief that fintech companies are the biggest threat to community banks going forward.³⁴

Consolidation

Across the industry, bank failures have declined sharply from peaks in 2009 and 2010. The entry of new banks to replace those that failed, moreover, was virtually nonexistent; only three applications for new, or “de novo,” banks have

been approved since 2011.

The lack of new banks has been attributed by regulators to a low interest rate environment that has hurt profitability, “making it relatively unattractive to start new banks.”³⁵ Bankers in our survey agreed:

“Banking as an industry over the past five years has required ... greater expenses to meet the demands of increasing regulations, the reduction of fees and interest rates to meet bank and nonbank competition, greater expenditures on cyber security, and the shortening of asset maturities to reduce interest rate risk, all of which have reduced the profitability of the business. Banking

is increasingly becoming an unattractive allocation of capital for the community bank investor and is leading to an eventual industry consolidation, which will leave only mega-banks, credit unions and nonbank intermediaries.”

An active merger market is suggested among banks in our survey, of which 10 percent said they received and seriously considered an acquisition offer in the past year (Figure 28).³⁶ Of those offers, more than half were thought to be motivated by market entry and nearly 40 percent by expansion within an existing market (Figure 29). Economies of scale in

FIGURE 24
Single Greatest Source of Current Competitive Pressure, Deposits

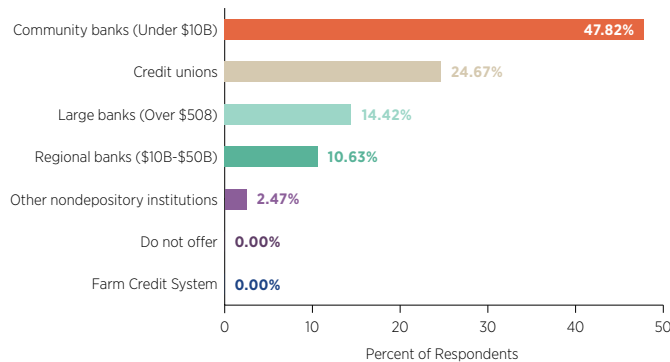


FIGURE 25
Single Greatest Source of Future Competitive Pressure, Deposits

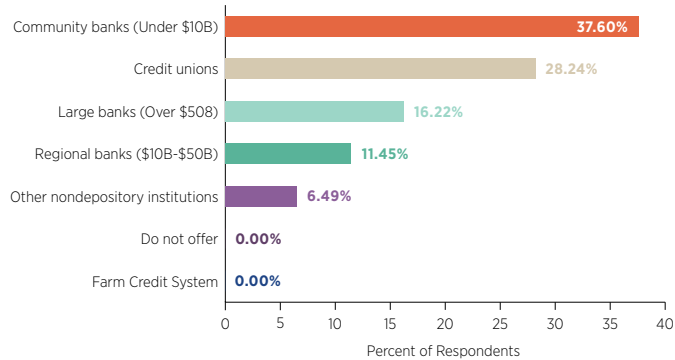


FIGURE 26
Single Greatest Source of Current Competitive Pressure, Payments

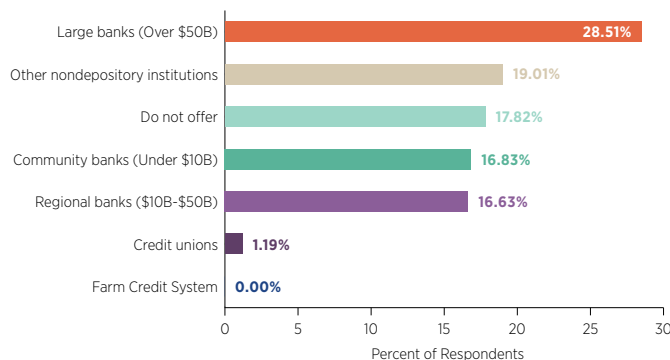
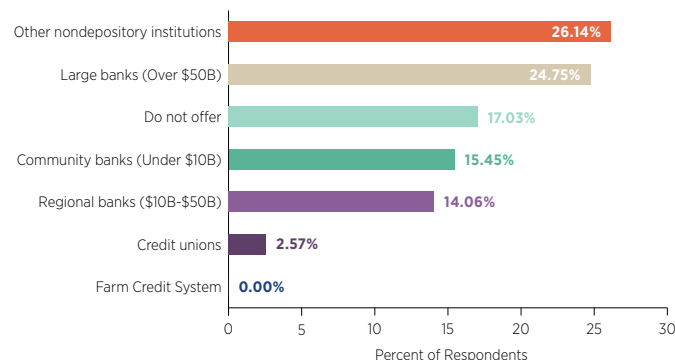


FIGURE 27
Single Greatest Source of Future Competitive Pressure, Payments



compliance costs were factors in some cases; one banker said that “the acquiring bank realized they needed to grow or the regulatory burden would crush them.”

As for the other side of the deal, 20 percent of banks in this year’s survey said they made an acquisition offer for a target institution in the past year (Figure 30). About 55 percent of the offers were motivated by expansion within an existing market and 45 percent were motivated by market entry (Figure 31).

Real or perceived succession issues were named by about 14 percent of banks as a motivating factor for acquisitions (Figures 29 and 31). Another recent survey reported a similar role, as 21 percent of respondents said that acquisitions were driven by succession issues.³⁷ These responses reflect a compelling interest in succession as a “generation of aging community bank executives starts to retire—or at least considers it—after seeing their organizations through the financial crisis.”

Regulatory obligations were said to have exacerbated succession issues. “We will be putting this bank up for sale within four years unless regulatory burden is eased,” one banker said. “I had two family members working here. Both left due to regulatory fatigue.” Another banker, a “fourth generation” family bank owner, said that because of regulatory burden it would be “next to impossible to hand over management and ownership” to his son upon retirement.

Succession issues also are reflected in problems described by bankers in

recruiting and developing managerial talent. They were attributed, somewhat ironically, to an expanding economy in which younger members of the workforce seek opportunities in urban areas with more “allure” than in rural areas, in which many community banks are located. Similarly, a “brain drain” has been blamed for problems “in attracting sufficient talent for future leadership of the bank.” This is a particular problem because of impending retirements of older management in many community banks.

“A small community bank does not have the ability to recruit and retain the expertise to carry on into the next generation,” one banker said. “This is a sad situation, as our bank has rated in the top 10 percent of earners and efficiency for probably the last 30 years.”

Another interesting difference—with respect to human psychology, if nothing else—concerns the role of perspective in describing motivating factors (Figures 29 and 31). In this regard, bankers mulling over offers for their acquisition often thought that the acquiring entities were seeking to capture managerial abilities (17 percent) but seldom thought that acquiring entities were interested in exploiting underutilized potential (9 percent). The converse was true for bankers in explaining why they were interested in a particular target. Among these bankers, 8 percent said they sought to exploit managerial ability and 27 percent said they sought to exploit underutilized potential.

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FIGURE 28
Have You Received and Seriously Considered Accepting an Acquisition Offer?

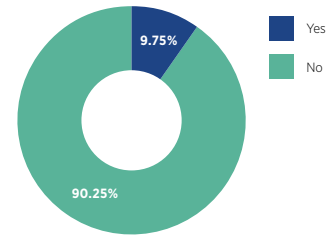


FIGURE 29
What Was the Most Likely Reason for the Offer?

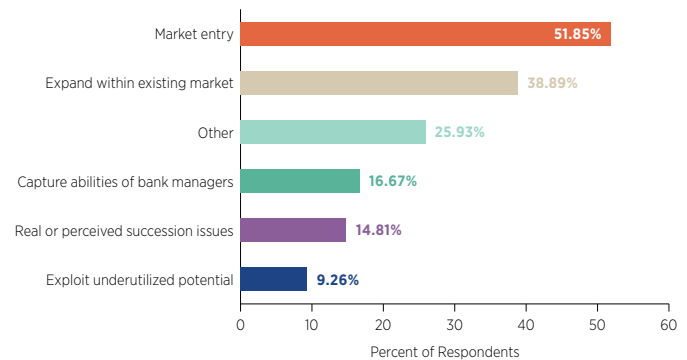


FIGURE 30
Have You Made an Offer to a Target Institution?

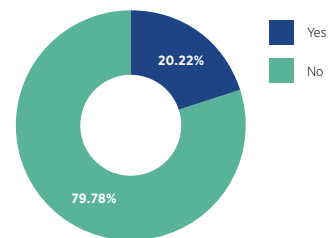
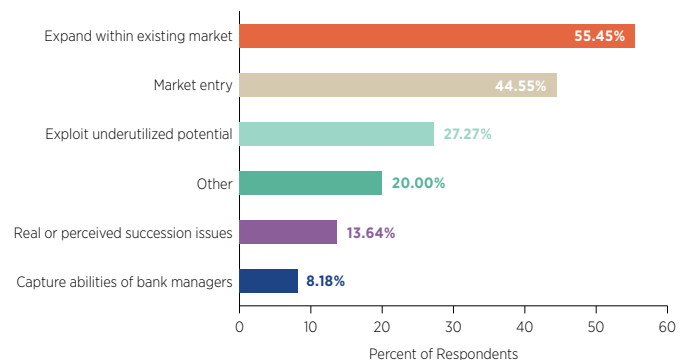


FIGURE 31
What Was the Motivation for the Offer?



The beat of the regulatory drum, heard loudly, frequently and clearly by community bankers in the years subsequent to the financial crisis, may have persisted to the point of tolerability.

Conclusions

Our survey offers an overview of the community banking industry, as described by the bankers themselves, in what is now the seventh year following the financial crisis. The survey was created in the spirit of an ongoing nationwide effort by researchers, policymakers and regulators to understand the nature of community banks and how they have evolved. For many of these banks' services, there are few, if any, substitutes.

Our report identifies a continued concern of community bankers with regulatory burden. We also observe, however, that mortgage lending, a heavily regulated activity, expanded last year and that the relative costs of compliance were stable. One banker in Kansas went so far as to characterize "regulatory costs as, generally, a reasonable cost associated with

the business of banking." The beat of the regulatory drum, heard loudly, frequently and clearly by community bankers in the years subsequent to the financial crisis, may have persisted to the point of tolerability.

Our report also illustrates a struggle of community bankers to understand the role of technology in how they serve their customers. Their apprehensions may have been presaged by earlier shifts of big banks "in earnest toward fintech and away from the regulatory compliance issues and cost-cutting fallout from the economic crisis."³⁸ A similar shift for community banks may now be underway.

In our inaugural report three years ago, smaller banks said they "needed to be willing to accept lower returns, at least in the short term," as they adapted to a new regulatory and technological landscape.

The survival of banks with assets less than \$500 million, or even \$1 billion, was said to be in doubt. But today, the profitability of community banks, while still lagging precrisis levels, has recovered to a greater extent than it has for the larger banks—the banks that some smaller banks earlier feared would overwhelm them. Community banks have, by and large, protected their share of the market for small business lending. And they continue to support the development of their local communities as they did before the crisis. ■

ENDNOTES

- 1 The number of states in which bankers responded to the survey differs from the numbers of states in which bankers participated in “Five Questions for Five Bankers.”
- 2 We note that loans in these categories do not necessarily dominate the lending portfolios of community banks. They were selected for analysis because of their topicality.
- 3 *Winning Strategies for Successful Small Business Lending*, Shorecap Exchange (July 2008).
- 4 “The Performance of Community Banks Over Time,” Council of Economic Advisors Issue Brief (August 2016).
- 5 For examples of how community banks and small businesses work together, see the CSBS’ 2016 Community Bank Case Study Competition Companion Journal available at www.csbs.org/bankcasestudy. The 2016 competition featured 23 teams from 20 colleges and universities that studied the impact of small business lending efforts by local community banks.
- 6 Federal Deposit Insurance Corp., *Quarterly Banking Profile, First Quarter (2016)*. This report measures growth from the first quarter of 2015 to the first quarter of 2016. It will be referred to hereafter as FDIC.
- 7 See “The Feed,” Farmer Mac’s *Quarterly Perspective on Agriculture*, Spring 2016.
- 8 “Community Banks, Small Business Credit, and Online Lending,” presentation by Lael Brainard, Federal Reserve Board of Governors, at the third annual Community Banking in the 21st Century research and policy conference, co-sponsored by the Federal Reserve System and Conference of State Bank Supervisors, Federal Reserve Bank of St. Louis (Sept. 20, 2015).
- 9 “Small Banks Seek to Grab a Bigger Slice of the SBA Pie,” John Roesti, *American Banker* (June 17, 2016).
- 10 In all figures, percentages represent the number of responses in a given category relative to banks that answered a particular question.
- 11 Nonperforming loan rates are taken from the FDIC. Expected deterioration in performance was identified in the Senior Loan Officer Opinion Survey on Bank Lending Practices, Board of Governors of the Federal Reserve System, January 2016.
- 12 See FDIC and earlier editions of the FDIC Quarterly Banking Profile.
- 13 Senior Loan Officer Opinion Survey on Bank Lending Practices, Board of Governors of the Federal Reserve System, January 2016.
- 14 QMs, which are more conservatively underwritten and, therefore, less likely to default, provide a measure of legal protection. Loans not meeting the QM requirements, on the other hand, may have borrowers or collateral that does not qualify to be sold through or insured by government agencies and government-sponsored enterprises (GSEs). GSE-backed loans currently represent the vast majority of the mortgage market.
- 15 A manager of another bank, however, was unimpressed, insofar as the bank “mainly operates in a county that has four times as many cows as people” and yet was not designated as a “rural county” according to the regulations.
- 16 “Outstanding Automotive Loan Balances Continue to Rise: Finance Companies Experience Largest Year-Over-Year Growth,” *Experianplc.com* (Feb. 9, 2016).
- 17 “Opening the Consumer Lending Market for Community Banks,” Brian Graham, *BankDirector.com* (April 23, 2015).
- 18 *Ibid.*
- 19 http://files.consumerfinance.gov/f/documents/Rulemaking_Payday_Vehicle_Title_Certain_High-Cost_Installment_Loans.pdf
- 20 See “Mobile’s Future is Here—Too Bad So Many Banks Are Stuck in the Past,” Tanaya Macheel, *American Banker* (July 6, 2016).
- 21 OCC, *Semiannual Risk Perspective*, Spring 2016.
- 22 We acknowledge limitations in matching data on a relatively small number of banks that responded to the survey with industry aggregates. We also recognize that survey data are subjectively reported. Our interpretations must be qualified accordingly.
- 23 It is worth noting that this estimated dollar amount is limited to community banks—in other words, it excludes the compliance costs at banks with assets greater than \$10 billion, which represent more than 80 percent of the assets of the entire banking industry.
- 24 The choice of which regulation is most confusing was a dilemma for some respondents: “Cannot choose,” one banker said, adding, “It’s the polar opposite of asking me which child I love most.”
- 25 “Call Reports for Small Banks Would Be Shorter Under New Plan,” by Lalita Clozel, *American Banker* (Aug. 5, 2016).
- 26 Statement of Martin J. Gruenberg of the FDIC before the Committee on Oversight and Government Reform, U.S. House of Representatives (July 13, 2016). In the first quarter of this year, for example, community bank net income increased by more than 7 percent compared with the same period in 2015, while net income declined at other banks by 3 percent. (See FDIC.)
- 27 “Credit Unions, Community Banks Duke It Out Over Planned Rule,” Ryan Tracy, *Wall Street Journal* (May 26, 2016).
- 28 “Banks Embrace Their Fintech Disruptors, Finding Ways to Profit,” by Jenny Surane and Miles Weiss, *Bloomberg BNA Banking Daily* (Aug. 1, 2016).
- 29 *Ibid.*
- 30 “Global Marketplace Lending,” Morgan Stanley (May 19, 2015).
- 31 Public Input on Expanding Access to Credit through Online Marketplace Lending, Department of the Treasury (July 17, 2015).
- 32 “Credit Unions, Community Banks Duke It Out Over Planned Rule,” Ryan Tracy, *Wall Street Journal* (May 26, 2016).
- 33 “The Future of Mortgage Lending Could Be Online,” by Scott Beyer, *Forbes* (Jan. 15, 2016).
- 34 “Fintech Poses No. 1 Threat to Community Banks, Execs Tell FDIC,” Gregory Roberts, *BNA Inc. Banking Daily* (July 21, 2016).
- 35 Statement of Martin J. Gruenberg of the FDIC before the Committee on Oversight and Government Reform, U.S. House of Representatives (July 13, 2016).
- 36 Differences in acquisition offers and observed mergers indicate that not all offers were consummated.
- 37 “Community Banks Show Renewed Focus on Succession Planning,” by Mark Sanchez, *Mibiz.com* (Jan. 10, 2016).
- 38 “Is Fintech Finally Gaining Ground?” Knowledge@Wharton, April 26, 2016.

A Summary of the Answers Given in Each State

To supplement and complement the survey of community bankers that was conducted for this conference, interviews were conducted with bankers in select states. The objective of the “Five Questions for Five Bankers” interviews was to create dialogue and put the national survey results into context at the state level. The questions were posed to five community bankers selected by state banking commissioners in 29 states. Responses are listed alphabetically by state in this appendix.

The questions concerned economic trends, regulatory burden, examination processes, competition in small business lending and personnel issues. The five questions that were asked of all the bankers were:

1. What emerging local, regional or national issues are of most concern to your bank?
2. What are the most time-consuming and burdensome regulations for your banks?
3. How do we remake the compliance examination process so that it is more valuable to bank management?
4. What types of competition are you facing from new types of lenders for small business loans?
5. How would you assess your ability to attract and retain employees?

The responses have been summarized in most cases into four broad areas: market conditions and the local economy; the current regulatory environment; small business lending; and management structure, succession and human capital.

continued on the next page ▶



Market Conditions and the Local Economy

Alabama bankers are concerned about the state's economic growth and the potential impact of a declining coal industry. For example, the largest manufacturer in one Alabama town creates products primarily used in coal mining. The manufacturer's sales have not met projections, which has led it to lay off employees. Additionally, manufacturers serving the agriculture industry are experiencing similar challenges caused by decreased sales and poor weather conditions. Alabama bankers have noticed that their customers are increasingly underemployed despite the most recent economic recovery.

Uncertainty about interest rates, pressure from nontraditional financial institutions and cybersecurity risks pose added challenges for Alabama bankers. They also expressed concerns about new chip-card requirements, with one banker stating that the "new chip-card program is being pushed out but I have not found a retailer yet that is ready for it, so it appears this is a wasted expense but one we don't have a choice but to bear because our liability increases if we don't issue these chip cards even though no one is ready for it." Furthermore,

bankers expressed concerns that their institutions assume most of the liability if debit cards are compromised, with little responsibility placed on retailers and customers. This issue may become more of a problem after the implementation of same-day Automated Clearing House (ACH).

On financial literacy, bankers believe financial education seems lacking in most rural communities and school systems. As a result, Alabama bankers are partnering with local schools and community organizations to increase proficiency. For example, one bank has created a financial literacy program for approximately 1,000 students at all of its area high schools. Program participants recently had a 70 percent certification rate. Another bank noted that its employees speak to more than 7,000 students annually, and the bank plans on opening two student-run school banks.

Current Regulatory Environment

Alabama bankers consistently said that the most time-consuming and burdensome regulations that they must comply with are the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA), TILA-RESPA Integrated Disclosures (TRID), ability-to-repay

requirements and the Bank Secrecy Act (BSA). Often, rules instituted to curb improper behavior among the largest institutions are similarly applied to smaller, less complex institutions, some of the bankers said. One banker complained of "impacts of Dodd-Frank regulations that are intended for banks in excess of \$10 billion that become 'best practices' for all banks, regardless of asset size and sophistication. The same for the rules and declarations of Consumer Financial Protection Bureau that create the same dynamic of 'best practices,' which become formal or expected requirements for community banks."

Alabama bankers also expressed concerns with the Current Expected Credit Loss (CECL) model, noting that it will "likely dramatically change how even the smallest community banks will be expected to estimate losses in the allowance for loan and lease losses calculation." Other compliance areas noted as unduly burdensome include the revised Military Lending Act rules, expanded BSA requirements for identification of beneficial owners, Regulation CC revisions and revised overdraft rules.

Alabama bankers provided a number of recommendations for regulatory relief. One

banker suggested exempting vacant land and construction loans from TRID rules, as well as streamlining those disclosure requirements. On the topic of compliance examinations, one Alabama banker recommended “more frequent and risk-based examinations that are targeted, rather than large, full-scope examinations every three years.” As an example, the banker recommended “a continual Community Reinvestment Act exam or targeted Lending Compliance examination rather than a single examination covering all compliance areas.”

Small Business Lending

Alabama bankers are seeing increased competition from nonbank entities, credit unions and the Farm Credit System, especially in the areas of consumer and agricultural services. But Alabama bankers’ primary competition remains community and regional banks.

Though Alabama bankers have experienced competition from online lenders in the mortgage space, the bankers have not witnessed similar competition when it comes to small business lending. For the most part, community bankers in Alabama have been able to sustain relationships with their customers over the years despite market changes.

Management Structure/ Succession/Human Capital

Alabama bankers are facing more challenges with recruitment than retention of employees. Banks serving rural communities find it difficult to attract younger employees to smaller towns, especially those prospective employees who recently completed college. The larger community banks in Alabama have not reported similar issues. One noted: “Historically, we have had success hiring experienced employees from large, regional banks who are looking for a more rewarding and fulfilling opportunity to be a true community banker, and work in an atmosphere and culture that provide a comfortable, lower-pressure, family-oriented work environment.”

Though Alabama bankers have had success with retaining employees, there are some barriers when it comes to specialty staff. One banker expressed concerns that the institution is often considered as a career stepping-stone for young and ambitious employees. The banker went on to state “millennials hop from one job to another, wanting to be in top positions the day they come to work and are not willing to give due time for training and experience to reach their career goals.”

To help employees develop new skills, Alabama bankers are providing a variety of opportunities, including on-site training from subject matter experts, webinars, seminars and computer-based training. Most training opportunities focus on compliance, emerging issues (e.g., prevention of elder abuse) and soft skills (e.g., telephone etiquette).



Market Conditions and the Local Economy

Arkansas bankers are concerned about the national economy, as well as negative trends in their specific market sectors. The recent shift in commodity prices, along with changes in the cattle industry, has caused challenges for bankers with portfolios comprised of agricultural credits. As one banker noted, cash flow from agricultural borrowers to other businesses has diminished; accordingly, bankers are noticing a negative impact on other businesses and customers in their bank.

Arkansas bankers expressed concerns that some of their competitors, including nonbanks, are not employing prudent lending practices. Also, the competitive pressure for banks to lock in low rates and price loans for longer terms has the potential to lead to further economic pressures when rates do increase. The concern is that the current economic environment encourages liberal lending practices similar to what was prevalent prior to the recent financial crisis.

Current Regulatory Environment

Arkansas bankers cited mortgage regulations as the

most time-consuming and burdensome. These bankers are concerned that current regulations make it difficult or impossible to serve existing customers who may no longer qualify under certain guidelines. Arkansas bankers noted that they have eliminated or modified some products due to mortgage regulatory changes.

In general, Arkansas bankers believe the compliance examination process creates barriers for community banks. The bankers shared various scenarios in which a compliance issue deemed to be a major or significant regulatory concern negatively impacted the bank in vast and prolonged ways.

Bankers also shared concern with how some regulators interpret or apply compliance regulations, as opposed to the substance of the rules themselves. Nonetheless, there was an acknowledgment that the size of an institution can truly factor into the cost of operating the bank's compliance program. Smaller institutions often have challenges when managing all of the costs of the compliance function. Compounding that issue, the volume of compliance regulations and the frequency in which they change make it difficult to remain current on the law.

Small Business Lending

Arkansas bankers indicated that small business lending is still a mainstay of their portfolios. However, they have noted that large, nonbank lenders have increased competition in this arena.

Arkansas bankers are concerned that the pricing and structure of small business loans can be challenging, especially in regard to matching the competition to maintain that business line in an institution.

Generally, Arkansas does not experience much competition from the virtual marketplace or the virtual business sector. That's because the virtual marketplace lenders have yet to become well-known in the smaller communities where many community banks operate.

Management Structure/Succession/Human Capital

The general consensus is that Arkansas banks and management teams have been focusing on staffing and management succession for several years. They collectively have engaged in searching for individuals to hire and train. Nevertheless, they feel that the challenge lies in being able to keep the staff engaged and motivated so that they can maintain longevity within

their organization. The bankers commented that in smaller markets it can be challenging to attract workers who have experience in certain areas; these bankers continually look for alternative ways to identify qualified staff and new employees.

Market Conditions and the Local Economy

Connecticut's economy has seen stagnant growth, a lack of new construction, and an exodus of young graduates and wealthy residents to states with less onerous taxes. The economy is very concerning to the state's community bankers, who see a significant and negative effect on their business, local economies and customers. Bankers noted that the state's economic woes and budget issues have led to a national perception that Connecticut is anti-business. The bankers believe that a concerted effort is necessary to put forth a more-balanced view regarding the state's highly trained workforce, established financial services industry and high quality of life for its residents. Connecticut's community bankers are also concerned about competition from fintech firms (financial technology companies), which are able to offer products and services without the level of regulation and supervision that banks face.

On a positive note, the community bankers expressed pride in the financial literacy and education efforts undertaken by their institutions. These efforts are increasingly important as school budget cuts, due to decreased state funding, make it less likely that financial literacy will be taught within the normal curriculum. One bank has "adopted" an elementary school, with plans to follow the students through middle school and high school. Additional community outreach programs include efforts to

educate first-time homebuyers, to combat financial-related abuse of elders, and to raise awareness regarding credit repair and credit building.

Current Regulatory Environment

Community bankers in Connecticut are experiencing difficulty with both upcoming and existing regulations. Many consumer compliance regulations have changed in recent years, and bankers have needed to dedicate a significant amount of time and resources to understanding the changes, educating staff, developing policies, implementing procedures and reporting. Qualified mortgage rules are seen as too prescriptive for the state's community banks, and the "safe harbor" does not instill comfort, given that the burden of proof is solely on the lender. Often, it seems that bankers are ready to implement new or changing rules, but vendors, attorneys and other third parties are not. In implementation of some mortgage rules, vendors were not ready with needed system changes, resulting in banks needing to delay mortgage closings. In one case, a bank had to halt mortgage lending entirely to allow its vendors to catch up.

Community bankers emphasized that the industry needs more time to adjust to regulations and to ensure that appropriate systems and processes are in place to address new requirements, especially with regard to consumer regulations. The bankers agreed that having a definition of a community bank

would bifurcate the industry with regard to regulation and compliance supervisory processes, and access to capital. Bankers spoke of a need for a more-consistent approach for compliance examinations. The compliance exam process should be more corrective and less punitive in nature.

Small Business Lending

Connecticut's community bankers continue to face competition from credit unions and regional banks. Competitors have relaxed credit standards and rates in ways that the community banks cannot. Competition also comes directly from the state through the Department of Economic and Community Development (DECD). Bankers believe that they should be the ones lending to businesses in the state, as opposed to the DECD's lending with taxpayers' dollars. However, bankers welcome the opportunity to partner with the department in situations where the latter offers credit enhancements for loans.

Management Structure/Succession/Human Capital

Connecticut's community bankers noted a pressing need to attract millennials both as customers and employees. Community bankers believe that the entry-level talent pool is strong. Despite this, attracting new employees is a constant struggle. One bank has created a three-year "emerging leaders" program, which has helped the bank fill more than 65 percent of its positions internally. Bankers in the state make use of staff

and director training through internal programs, through programs sponsored by the Connecticut Bankers Association, and through external programs such as the Connecticut School of Finance and Management and the American Bankers Association's Stonier Graduate School of Banking. Bankers noted that education grants are available from the Department of Labor. Also, a local state university is working to create a banking MBA program.

Rising salaries within some areas, including technology, are helping some banks to retain staff. Incentive-based pay is not always enough to keep employees if an employer does not offer competitive health insurance. Although some workers have left the state for other states with better economies, banks indicated that they were generally able to attract sufficient talent for succession.

Despite increasing pressures and a negative perception of the banking industry, Connecticut's community bankers are committed to maintaining quality lending portfolios, investing money and resources into their staff and communities, and continuing to offer consumers a choice in financial services.





Market Conditions and the Local Economy

Georgia bankers are concerned over the current environment of low interest rates. A flat interest rate yield curve prevents banks from achieving an adequate yield even by acquiring assets that are further out on the time horizon. This environment has driven down banks' net interest income and has placed great pressure on efficiency. The pressure toward efficiency is a driving force toward merger and acquisition (M&A) activity. When combined, all of these issues threaten the community bank model, according to Georgia bankers.

Despite these challenges, Georgia bankers reported that local and state economies are stable and improving. Competition for loans has led large banks to move down in the market to the area of small loans, previously the exclusive domain of community banks. Although demand deposits are reportedly plentiful, the bankers who were interviewed recognized that this dynamic could change quickly on return to a rising-rate environment. One banker described these demand deposits as "angry deposits" that will quickly leave to take advantage of higher rate products once there's a greater differential in rates.

Current Regulatory Environment

One Georgia banker indicated that his bank has made a conscious decision not to abandon the mortgage market even though it feels as if it spends an inordinate amount of time on compliance. According to the banker, the process of closing loans has been slowed by the focus on ability-to-repay regulations, disclosures and the general process of compliance. This banker felt that the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the TILA-RESPA Integrated Disclosure (TRID) did not make the closing process clearer or safer for borrowers.

Georgia bankers reported that they have become preoccupied with complying with mortgage rules because of the ramifications of noncompliance. As a result, one bank purchased a more-expensive underwriting software package and has engaged with outside compliance specialists at significant cost. This bank is strictly limiting its mortgage lending to qualified mortgages; however, it feared that any foreclosure would be construed as evidence that the borrower must not have truly had the ability to repay, despite the obvious change in a borrower's condition

between origination and default.

Concerns were also expressed regarding the Federal Deposit Insurance Corp.'s compliance examinations of third-party payment processors. Frequently, bank customers are accounting firms that process payroll for local businesses, and the regulations and resulting examinations appear to focus very heavily on the recipients of the Automated Clearing House (ACH) transactions—a "know your customer's customer" issue. While the bank's business line itself has not been criticized, the regulatory burden and risk easily outstrip the return and may result in the bank's ending its relationship with these customers. Georgia bankers expressed concern that a once-profitable business line will be forced into unregulated areas like those served by virtual currency companies and marketplace lenders.

Georgia bankers noted that nonbank lenders have become serious competitors for them in the mortgage lending area. One banker noted that, by watching deed filings, he observed that more than 30 percent of the mortgages in the bank's market were closed by a nonbank mortgage lender. In response, the bank is looking at third-party solutions to help compete.

Small Business Lending

There is concern among Georgia bankers that competition for small business lending is increasing as large banks in the market have begun pursuing smaller credits. Georgia bankers reported that a large bank can provide a large unsecured credit to a small business in a matter of a few days, whereas, if a community bank were to provide the same product on the same terms, it would generate considerable regulatory concern.

One banker expressed concern about the small business lending models being rolled out by financial technology companies, relating that loans were being granted to companies that would not even qualify for Small Business Administration (SBA) loans. At the same time, he expressed skepticism as to the long-term viability of these same “fintech” companies. Nevertheless, this banker’s lending specialization faces only moderate competition from large banks and has not been a target of the fintech companies.

Management Structure/ Succession/Human Capital

Georgia bankers indicated that the financial crisis had not affected their ability to retain staff. According to the

bankers, talent at community banks typically had to be developed through on-the-job training, by sending bankers to formal training provided by the industry trade groups and by participating in industry roundtables. The bankers noted that large banks do not typically operate the comprehensive training programs they once did; instead, employees and officers in large banks are very specialized and put in “silos,” making them less of a fit for a community bank.

A major concern among Georgia bankers was the lack of interest among younger people in pursuing a career in banking. In fact, many bankers reported that they would have reservations about recommending banking as a career to their own children. That being said, many bankers felt that this perception appears to be unfairly driven by negative press and scapegoating in the political arena.

The bankers noted that commercial lending officers are commanding higher salaries as competition for quality workers in this area has increased. Similarly, there is reportedly an increased demand for compliance officers for both the lending and deposit operations areas, especially as the banks turn to third-party vendors and

consultants to augment their compliance efforts.

Georgia bankers reported difficulty in maintaining management depth, which poses a challenge to succession planning. While this increases risk, the bankers felt that it was still manageable, as the banks would typically have sufficient staff to continue to operate while a new executive was being sought. Those bankers who were interviewed said they felt that workers in the banking industry had become less transient, but the interviewees pointed out that this could be economy-driven.



Market Conditions and the Local Economy

Idaho's community bankers are optimistic about the state of the local economy. The state recently led the country in job growth and has one of the lowest unemployment rates in the nation. Construction job creation is particularly strong. Although the growth in construction has led to solid loan growth, an Idaho banker noted that there is concern about rapid growth leading to a housing bubble. Bankers who were interviewed also noted that low agriculture commodity prices are a concern. Other concerns included the impact of prolonged low interest rates, the need for improved infrastructure, and immigration policy, given Idaho's dependence on a migrant workforce for agriculture.

Current Regulatory Environment

Idaho's community bankers are increasingly finding themselves "forced into a box" due to regulatory restrictions. Bankers noted that the barrage of new and changing regulations disproportionately affects community banks, saying that their nonbank competitors are not held to the same standards. One banker noted that his compliance staff had grown from one to five over the past

10 years. Regulations that were mentioned as being most burdensome and time consuming were the TILA-RESPA Integrated Disclosures (TRID), the Home Mortgage Disclosure Act (HMDA) and the Federal Accounting Standard Board's Current Expected Credit Losses Accounting Standard Update (CECL).

With regards to TRID, the bankers said that the regulation has added significant time and paperwork to the process for making a real estate loan. Clarity is particularly lacking regarding construction loans. The bankers reported that TRID has resulted in increased compliance costs. Each loan receives a separate review for TRID compliance, and one bank reported that it reviews each loan twice before disclosures are made to consumers. The increased data requirements for HMDA are consuming much of compliance officers' time, and there is significant concern about HMDA-type data collection requirements for small business loans. Due to concerns about fair lending, Idaho's bankers feel that they are unable to price for risk on consumer loans. The bankers expressed a strong desire to continue to make mortgage loans. However, the regulatory burden and compliance risk have caused several bankers to consider

exiting mortgage lending altogether.

In general, the bankers said they strongly believe that the federal regulators need to focus on implementing "right-sized regulation." The bankers referred to the "constant creep" of new and changing rules. The pace is unmanageable and federal regulators should "pause to allow everyone to catch up."

Ideas for improving the compliance examination process included holding pre-exam discussions to better plan for the scope the exam, performing additional work off-site and generally making the process more of a teaching experience.

Small Business Lending

Idaho's bankers are experiencing serious competition from credit unions, the Farm Credit System, and insurance companies. One banker said that local and out-of-state credit unions have started a race to the bottom in terms of underwriting and pricing. Banks are not willing to lessen their underwriting or to take on the risk of offering very long terms with fixed rates on small business loans. The bankers were optimistic about their ability to compete with online lenders. Some are now offering online loan application processes. Generally, the community banks in the state still have an advantage given

the relationships they have built with their customers.

Management Structure/Succession/Human Capital

Some of the bankers reported success in attracting and retaining employees, while others stated that it was difficult to find talented employees who want a career at their banks. Smaller banks noted that some candidates were concerned about the potential for ownership changes and were reluctant to relocate to small communities. The bankers noted that the career of banking does not have an allure for younger people.

The bankers reported significant competition for skilled commercial lending officers, with bank and nonbank competitors "raiding" each other's lenders. Salaries and the ability to provide for growth opportunities are major factors.

All of the bankers who were interviewed have training programs for employees and board members. The banks also provide education assistance for college courses and pay for certifications and for employees to attend banking schools. It was also noted that the mentoring of employees, in addition to training, is an important component to development.



Market Conditions and the Local Economy

Illinois bankers expressed concerns about their state's budgetary challenges. The Illinois legislature's failure to pass a budget has caused banks to assess potential risks in the event that the state fails to meet certain financial obligations. In addition, the bankers expressed concerns with population stagnation and a lack of new businesses coming to the state. Contractors have been observed to be struggling to pay their bills and having to lay off people.

Regarding national issues, Illinois bankers are concerned about the 2016 presidential election and the effect it may have on trade agreements. There is concern that people in their communities are not eager to invest in creating new businesses or expanding existing businesses.

A few Illinois banks indicated that while check-processing had been a reliable source of income in the past, their income from such has become limited with increased competition from technology-driven payment channels.

Some Illinois bankers questioned the expenses associated with rising fraud involving debit cards, fearing that chip-and-pin technology will be a failed attempt to solve the problem, which would leave the banks scrambling. As technological advances come along, community banks struggle to keep up. Integrating new technologies generally requires banks to rely on third-party providers. The amount of time researching

and vetting different vendors stifles innovation. In addition, third parties are regularly increasing their prices as they, too, struggle with mounting regulations.

Current Regulatory Environment

Illinois bankers indicated that the most time-consuming regulations for them were the new federal mortgage rules. There was a consensus that new mortgage rules have increased the time to complete an application. Bankers agreed that the size of the application has doubled over the years and is increasingly confusing to consumers, as well as to bank officers.

In addition to the new mortgage rules, Illinois bankers named the Bank Secrecy Act (BSA) and fair lending rules as onerous regulations. One banker also raised concerns about categorizing local customer deposits in a reciprocal deposit program as brokered deposits. According to the banker, this program helps a customer diversify risk while at the same time helps the bank lower its cost of funds, lower security pledging requirements/costs and meet the needs of its larger depositors.

There is much fear over the new Current Expected Credit Losses (CECL) rules. Illinois bankers commented that new regulations seem to be most appropriate for big banks, while negatively impacting the bottom line of smaller community-focused banks.

A number of Illinois bankers stated that they have stopped offering certain

products due to burdensome regulations. For example, one Illinois banker felt compelled to change course on products including Small Business Administration (SBA) loans, government loans, student loans, Veterans Affairs (VA) loans, mobile banking, social media and mobile check scanning.

Illinois bankers indicated that it would be helpful if the examiners assisted banks with understanding regulatory requirements and the best practices for complying rather than being told to "just do it" with no examples or direction of what the regulators want to see. One banker suggested reducing the testing period, making it timelier rather than asking for items 18 to 24 months in the past.

Small Business Lending

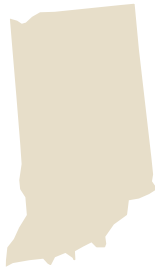
Illinois bankers face their strongest competition from other banks, credit unions and the Farm Credit System. Bankers noted that both credit unions and the Farm Credit System were expanding to originate loans that were more commercial in nature, even though those entities were not initially created for that purpose.

Management Structure/Succession/Human Capital

Bankers indicated they used a variety of training methods, including on-the-job training, classes offered by trade associations and training modules on a vendor's website. Bankers are experiencing varying challenges with attracting and retaining specialty staff depending on the banks'

location. In the larger cities, it is not difficult to attract talent. However, in the smaller, rural areas, the cost to attract these specialized employees is higher. Two smaller, rural banks noted that they had great difficulty finding qualified IT or compliance staff. One Illinois bank said it had to go to third-party vendors for expertise in these areas, and the bank's staff oversees the third-party's work. This has proven very costly to the bank.

The size of the community was reflective of the level of concern with succession planning. Smaller, rural banks were concerned with the talent pool and its migration to bigger communities. A few family banks indicated they felt fortunate that they had relatives who would continue the banking business. The banks in the bigger cities were not concerned, as management had succession plans, with existing senior managers having sufficient talent to manage the bank given any unexpected change.



Market Conditions and the Local Economy

Indiana community bankers noted that unemployment is largely not a problem in their state, with only a few counties struggling to recover from the most recent crisis. Several bankers commented that their loan pipelines are doing well and that their banks have been exploring new markets. While banks are reporting geographical pockets of lending opportunities, additional loan demand is desired in other areas. According to one banker, it is “very apparent that many/most bankers feel they have excess capacity within their organization, their operational structure and their funding base.”

The bankers expressed concerns with their ability to attract and retain millennial consumers. According to one banker, millennials want “all interaction to be via a mobile platform, and this is difficult to implement for small and mid-size banks due to cost and expertise.” Bankers noted that this is especially difficult for rural and small-town banks, many of which simply don’t have the resources to produce platforms that appeal to younger generations.

Current Regulatory Environment

The bankers noted that there is no single regulation that is overly burdensome, rather there are several regulations that are challenging, time consuming or should be revisited. For example, one banker noted that the Community Reinvestment Act (CRA) is burdensome and that the amount of work it requires does not result in positive outcomes for the communities it is supposed to help. According to one banker, CRA is not necessary for rural community banks, commenting, “At the end of the day, a bank located in a rural community must service its entire community or it will not survive.”

One community banker said that the Herfindahl-Hirschman Index (HHI) is outdated, specifically in how the calculation interacts with remote deposit capture. This banker said, “The current way deposit share is calculated creates numerous issues, like how deposit share is calculated based upon where the deposits are captured.” Thus, if a consumer utilizes remote deposit, the deposit is considered a deposit wherever the aggregation software is housed, instead of where the consumer lives.

The processes implemented by the Bank Secrecy Act (BSA) are also considered problematic, specifically, the filing of Suspicious Activity Reports (SAR). One banker noted that the filing guidance is inconsistent and differs from examiner to examiner,

resulting in “undue concern.” One respondent offered a solution, saying, “Unless there is a glaring issue, the examiner should defer to the bank that was the closest to the transaction, especially when the decision to not file a SAR is well-documented.”

Community bankers also expressed concerns about the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the TILA-RESPA Integrated Disclosure form (TRID). Bankers noted that TRID has produced more customer complaints at banks than any other area. According to one person who was interviewed, “Mortgage lending processes take longer, and the number of times that a closing must be delayed is significantly increased.” This can often have a snowball effect, as the closing of one home sale is often dependent upon the closing of the borrower’s prior home. This can create a domino effect, where the delay in one closing impacts closings for multiple families and multiple homes. Many bankers also feel that the paperwork is often confusing for customers, despite TRID’s intended purpose to streamline the process.

Small Business Lending

Online lenders and credit unions present competition to the Indiana community bank. One banker noted that “non-traditional lenders are starting to have an impact in this arena, even though these loans are much more expensive.” Credit unions are pursuing

the agriculture lending market aggressively in Indiana, and credit unions are continuing to expand their portfolios in small business lending.

The community bankers expressed concerns about small business borrowers turning to online lenders because these online lenders do not have proper financial guidance and cannot meet the same expectations that customers would have of community bankers. One respondent said that a solution to this would be “third-party assistance for providing small business development training.”

Management Structure/Succession/Human Capital

Indiana community bankers noted that finding good talent and retaining good talent have become less difficult and that “mergers in Indiana are creating recruitment opportunities.” Training is largely done in-house, and recruitment for open positions is often from within. Generally, staff recruitment in information technology remains a concern, and compliance personnel are more difficult to find.

Market Conditions and the Local Economy

Community bankers in Kansas expressed concerns about lending connected to the commodities sector, including within the agricultural and energy industries. Kansans are beginning to witness tightening in agriculture after past sector growth largely insulated Kansas communities from the worst effects of the Great Recession. Prices have declined in some niche areas that are key to rural markets, including cattle and grain. Bankers have noticed their agriculture-based customers struggle to meet financial obligations as they have seen their disposable income diminish. Still, some bankers noted that, overall, the agriculture industry is healthy despite depressed prices.

The oil and gas sector’s recent slump is impacting Kansas communities in varying ways. As more and more oil and gas companies have allowed their leases to expire, there have been very few replacement deals. There has been an increase in marginal wells—oil and gas wells that have become unprofitable to operate and so have been either shut down or plugged.

Similar to 2015, bankers reported strong employment numbers in Kansas; nonetheless, there are concerns that some institutions’ client bases may be diminishing due to a number of factors. Some Kansas communities have witnessed slow population growth coupled with an aging community. Furthermore, millennials seem to exhibit a distrust of traditional banks

and a preference for online financial services.

Community bankers also acknowledged that the low-interest rate environment has placed downward pressure on their profit margins. Bankers are also competing with nonbank entities subject to less regulatory scrutiny. They expressed the most concern with financial technology competitors in the payment systems space since a large portion of a community bank’s funding comes from core deposits.

Kansas bankers are generally optimistic about financial literacy initiatives undertaken by their state’s education board. Still, some are concerned that generational preferences for online services make it difficult for students to master the basics of finance (e.g., how to balance a checkbook).

Current Regulatory Environment

Rules related to the Home Mortgage Disclosure Act (HMDA) and TILA-RESPA Integrated Disclosure (TRID) were consistently cited as the most time-consuming and burdensome regulations. Bankers are concerned that both areas of regulations continue to change and are increasingly more complex. Furthermore, Qualified Mortgage (QM) rules were noted as specifically burdensome for rural bankers. These bankers are worried that the QM rules create barriers for bankers looking to serve individuals with irregular incomes, including farmers and small business owners.

Some bankers have noted that they have limited their

service or product offerings (e.g., demand deposits and small-dollar loans) due to regulatory risk and compliance exposures. Nonetheless, other bankers noted that certain products (e.g., mortgages) make up too large a percentage of their portfolio to alter regardless of regulatory burden. One banker characterized regulatory costs as, generally, a reasonable cost associated with the business of banking. Still, most bankers have expressed greater need for clarity in various regulatory areas (e.g., related to flood insurance).

Kansas bankers consistently recommended that regulators tailor rules according to the size and risk profile of banks. For example, one bank recommended that regulators start issuing “small entity” guidelines whenever publishing new rules, while others recommended tiered reporting requirements based on size. Examination reforms were also suggested, specifically when it comes to consumer compliance exams. For example, bankers recommended that examiners approach their consumer compliance reviews with intent to help bankers comply, as opposed to with intent to punish.

Small Business Lending

Kansas bankers have not witnessed much competition from financial technology companies within the small business lending space. Competition remains mostly among peer banks and regional banks with Small Business Administration’s preferred lender status.



Management Structure/ Succession/Human Capital

Some bankers expressed concerns about a “brain drain” in rural communities where the talent pool is more limited. Nonetheless, Kansas bankers find attracting talent to be only moderately difficult; most of their human capital challenges involved staff retention. Lower-wage employees are more inclined to leave, especially since some banks require work on Saturday. Furthermore, higher-level personnel can be unaffordable, especially those who will demand higher wages over time. Compounding this issue, the millennial workforce tends to be more transient than its predecessors. Bankers noted that it takes five years to train employees toward desired productivity; however, many millennial workers begin looking for new opportunities after five years, taking with them valuable skill sets that are acquired only with time.

Most Kansas bankers noted that they train their workers on the job and rely heavily on resources that are online or from third parties. They also rely upon seminars from the Kansas Bankers Association, the American Bankers Association and various graduate banking schools.



Market Conditions and the Local Economy

Kentucky community bankers state that in larger metropolitan markets, economic conditions are stable and beginning to grow. Conversely, in some smaller, insular communities that were highly dependent on coal production, economic conditions are depressed, with minimal growth expectations. In the eastern part of the state, there has been approximately a 50 percent decrease in coal-related jobs, which has resulted in an increase in both loan delinquency rates and mortgage foreclosure rates. In general, bankers reported that there is a reluctance to take on more debt among businesses and consumers alike. Small businesses are not borrowing for capital expenditures or to expand operations, and there is a very low usage of operating lines. Among consumers, mortgage demand is noticeably weak in areas impacted by the decline in coal production; however, larger cities and bedroom communities are experiencing a slight demand in consumer mortgages.

Kentucky bankers observe that smaller towns are experiencing a declining population while larger towns are growing as residents have migrated to metropolitan centers in search

of jobs. In these metro areas, bankers report that competition for real estate loans is strong, and some lenders are loosening underwriting standards to originate loans. Bankers in rural areas report that companies will decline to relocate there due to a small housing market, workforce limitations and minimal recreational opportunities. Also, some companies in need of low-skilled labor are having difficulty filling openings for various reasons.

Bank customers in Kentucky are generally demanding a quicker, more convenient payment system that does not rely on checks. Despite offering peer-to-peer money options, bankers reported that not many customers use them. While customers in smaller towns generally prefer physical branches, customers residing in larger cities prefer using online services over branch locations. Kentucky bankers reported that nonbank competition for payment services is strong, but they foresee this as a potential source of legal risk. There has been a significant increase in debit card fraud. To counteract this, bankers are requiring certain retailers with high incidences of fraud to use swipe and pin for all debit card transactions. Other anti-fraud measures are also being used.

Financial literacy is a major concern among Kentucky bankers given the high number of unbanked and underbanked individuals. The younger generation, with no credit history, has easy access to credit, with many lenders not requiring collateral or a co-signer. However, there is no specific required financial training in high school or college, leaving many borrowers unprepared. Many banks offer free financial literacy courses to customers, but there has been a general lack of interest. Some banks are attempting to start co-op programs with local high schools to encourage students to look at the banking industry as a career.

Current Regulatory Environment

The most time-consuming and burdensome regulations, according to Kentucky banks, are the real estate disclosure rules, fair lending regulations and the ability-to-repay/qualified mortgage rules. The Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the TILA-RESPA Integrated Disclosure Form (TRID) are doubling the amount of time required to close a mortgage, even assuming the disclosure contains no errors. If errors are noted prior to closing, additional delays occur as

redisclosure is required. Lending not subject to TRID can close in a fraction of the time. Bankers expressed frustration over the time and paperwork required to close a \$45,000 mortgage loan compared to a \$60,000 car loan, which can be approved and closed in an hour.

Additionally, Kentucky banks reported difficulties with the regulatory approach adopted in enforcing fair lending laws. Regulators are reportedly taking a zero-tolerance approach and requiring numerous reviews, which is hampering the industry's ability to develop new products. The ability-to-repay and qualified mortgage regulations do not allow a bank sufficient flexibility in dealing with customers. Kentucky bankers express frustration that mortgages originated and held in portfolio were not conclusively granted qualified mortgage status, given the fact that the bank retains the credit risk on the loan and has "skin in the game."

On the subject of regulatory reform, Kentucky bankers advocate reforming consumer protection regulations. Respondents reported a need to conclusively grant Qualified Mortgage, or QM, status for mortgages held in portfolio, reform the enforcement of the disparate impact rules of the

fair lending laws and adjust the degree of tolerance given when deciding whether a redisclosure is required under TRID. Several other regulations could be changed or improved as well, including appraisal regulations, Community Reinvestment Act (CRA) regulations and the proposed small-dollar lending rule.

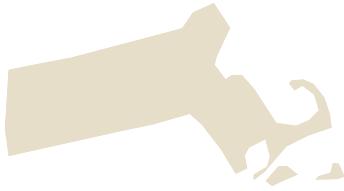
Regarding appraisal regulations, Kentucky bankers noted that there are very few qualified appraisers in rural markets, forcing them to rely on appraisers from outside of the market with limited or no knowledge of the market. They recommend changing the appraisal rules to allow for a market value opinion in a small market where the bank is keeping the loan in its portfolio and the customer has a low risk profile (e.g., low loan-to-value, well-documented repayment source, etc.).

Additionally, Kentucky bankers recommended reforming the CRA rules to broaden the types of activities for which a bank would receive credit. This change would allow the banks to innovate in helping their communities. On the proposed small-dollar lending regulation, the bankers reported concerns that the proposed rule would further push banks out of the small-dollar loan market, given the high

compliance costs compared to the return. Kentucky bankers said that new and changing regulations were more burdensome than existing regulations. They cited the difficulty of keeping employees current on regulations despite regular training efforts.

Whether new or old, many of the regulations were reported as impacting the products and services offered by Kentucky banks. Specifically, bankers reported that they do not offer credit lines or small-dollar loans due to regulatory burden and compliance costs. Likewise, new rules have severely hampered customers' access to overdraft services.

Community banks in Kentucky stated they should be permitted to form compliance service companies to distribute the increasing compliance costs. They believe that banks must collaborate with one another to achieve economies of scale or else they will be forced to sell to larger competitors. Finally, bankers in Kentucky strongly believe that institutions with a low risk profile should receive less regulatory scrutiny. According to the respondents, a high capital ratio, simple balance sheet and a satisfactory regulatory rating should result in lower compliance requirements.



Market Conditions and the Local Economy

The Massachusetts economy has been strong in comparison with the New England region and the nation. The pace of economic growth increased in the first quarter of 2016, following a tepid second half of 2015. The labor market is generally healthy, although concerns remain about the level of underemployment in pockets of the state that lag behind.

Banks expect the current interest rate environment to continue. Tight rate spreads remain an ongoing challenge. However, banks have modified their portfolios, and some reported their best earnings in recent years. Exercising caution in the event of a mild housing correction, some banks are placing special emphasis on borrower liquidity.

Urbanization has a particularly strong impact on Massachusetts and carries implications both for staffing demands and the customer base.

Banks emphasize the challenges associated with offering small-dollar loans that are both appropriately priced for risk and that comply with federal and state law. Additionally, banks continue to rethink overdraft offerings, compounding the severity of liquidity challenges in underbanked communities.

Many banks continue to choose not to serve money-services businesses due to concerns about the Bank Secrecy Act (BSA), concerns that also contribute to banks' unwillingness to serve the marijuana industry. The result in many cases is a withdrawal of services from areas that would derive significant benefit from them.

Current Regulatory Environment

Community banks are critical of a one-size-fits-all approach to regulation, which they say is disproportionately burdensome on small- and mid-sized community banks. Some banks have considered scaling back residential mortgage operations, citing the compliance burden and cost associated with ability-to-repay rules, the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA), the TILA-RESPA Integrated Disclosure form (TRID) and the Home Mortgage Disclosure Act (HMDA) as the primary reasons. For example, some remain reluctant to offer construction-to-permanent loans due to uncertainty about the timing of TRID disclosures. A few bankers said that residential mortgage loans have become a break-even product, given increased compliance and other costs. Others

said they have been compelled to operate more efficiently in light of increased regulations that tax staff with multiple duties.

Most banks make few exceptions to their practice of originating only qualified mortgage loans. Transactions often break down or fail to meet customers' needs due to the weight of paperwork and redisclosure. Bankers also stressed the need for more streamlined BSA requirements. Customers do not always understand the impact of regulations and may misinterpret as mistrust or suspicion bank protocol in response to regulatory requirements.

Most bankers focused their suggestions for regulatory relief on the idea of right-sized regulation. They proposed examination cycles and assessments be tailored not only to size but also to other factors, such as risk profile, business model, prior CAMELS ratings, complexity and capital. Some banks cautioned against a simplified capital threshold for scrutiny, fearing that conservative ratios might become an industry benchmark that discourages growth.

Bankers said they found regulator-run seminars and guidance helpful in managing the high number of regulatory updates. Noting the usefulness of self-assessment tools, for

example, they requested more opportunities for step-by-step “guides to compliance” from regulators. The bankers indicated that detailed assistance with complicated compliance topics—independent of examinations—is highly desirable.

Bankers continue to feel improvements can be made in compliance examinations. Citing the benefits of the risk-management nature of safety and soundness examinations, executives asked that examiners make an effort to foster an atmosphere of collaboration with banks. Additionally, banks emphasize that modernizing data collection techniques and exam procedures could make exams more efficient.

Small Business Lending

Massachusetts small business lending is a competitive local market. Community banks maintain that their primary competitors are other community banks, large mutual banks and credit unions of a similar size; the community banks are confident they can compete. Many banks contended, however, that credit unions that employ loose underwriting standards can distort competition in an otherwise healthy market.

To the degree that small business owners refinance credit card debt with term

loans, community banks are challenging the major credit card debt holders. However, community banks generally compete with national banks only when pursuing larger commercial deals.

Marketplace online lenders are a growing topic of discussion among bankers and regulators. Some bankers view them as a serious competitive threat, while others do not. This seems to vary based on geography and customer demographics. Bankers advocated for a level playing field, saying that marketplace lenders are subject to less regulation and scrutiny.

Management Structure/ Succession/Human Capital

Community banks, particularly those in rural and seasonal areas of the state, identified significant challenges in attracting and retaining talent. Urbanization is the most significant of these, especially with regard to specialty areas such as information technology. Bankers also said that many valuable industry training programs had disappeared, leaving smaller banks with fewer options for developing staff expertise. Increased consolidation has benefited some banks, which were able to hire talented staff displaced by mergers.

A bright spot for many community banks has been the level of engagement from board members. Banks are successful in retaining members, and most have board succession plans in place. Of note, several banks have indicated that they intend to bring on one or more members with IT and cybersecurity experience to provide oversight and expertise in these important areas.



Market Conditions and the Local Economy

Issues facing Mississippi community banks span the local, regional and national stage, with the severity varying by geographic location of bank branches and the primary industries in those areas.

Local and regional issues are emerging in the areas of management transition and the composition of a community bank's loan portfolio. Commodity prices and the Farm Credit System (FCS) top the list of concerns in agriculture-driven markets, while volatile real estate prices are a larger worry for banks with a presence in university towns. While asset composition poses concentration risks for many Mississippi community banks, bankers have adequately assessed risk exposure and mitigated it in markets where feasible. They effectively monitor it in areas where significant asset diversification is not possible.

As with many community banks elsewhere, the impending retirements of aging management teams have presented new challenges. Consequently, many small community banks have elevated the dialogue surrounding management transition, staffing and succession planning.

Some potential local and regional risks are effectively

mitigated with strategies that lessen risk exposure to bank earnings and operations. Many Mississippi community bankers feel that federal regulations have changed the landscape of community banking. Concerns include longer application processing times, overzealous Consumer Financial Protection Bureau involvement and the lack of oversight over it, potential cybersecurity incidents, and the outcome of the presidential race.

Historically, Mississippi community bankers have relied on third-party relationships to ensure safe and sound operations. However, many state that a heavier reliance has been placed on third-party services to ensure ongoing compliance with safety and soundness, consumer protection and the Bank Secrecy Act (BSA) regulations. Additionally, customer expectations of certain services, such as ATMs and online banking, have fueled the reliance on third-party contracts.

While demographically distinct, Mississippi community bankers are aligned in their mission to provide financial literacy to their communities. Where formal programs such as A Banker in Every Classroom and Fresh Start initiatives are not available, some bankers provide the basics on

checking accounts and budgets to new account holders and their children. Bankers also partner with university extension services in providing financial education.

In more rural communities, where a larger part of the population is financially illiterate, older people in some cases have been victimized in their transactions. This increasing trend has driven the need for more financial awareness in those areas. By the nature of community banks, financial literacy is viewed as an investment in the community, regardless of the difficulty in attracting an audience.

Current Regulatory Environment

Mississippi community bankers blame Dodd-Frank and compliance-related regulations, such as the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA), the TILA-RESPA Integrated Disclosure form (TRID) and the BSA for placing the heaviest regulatory burden on their banks. Community banks have invested more in their infrastructure in the form of human capital, software and increased reliance on third parties to maintain compliance with all regulations. To lessen this burden, some bankers contend that "Congress should

not be making rules because they are disconnected from the financial realities of our communities" and that "regulations should be tailored to the environments that the banks serve."

Overall, bankers believe that it is not the creation of rules, but the continued revision of guidance for and interpretations of existing rules that are causing the most problems; however, they state that relief from federal mandates related to home lending would be most beneficial to community banks.

Mississippi community bankers have discontinued certain products and services because of the costs of compliance and implied fair lending risks. Some of these services include overdraft protection, mobile/manufactured home lending, student loan lending and private banking for students in medical school.

Overall, bankers said that current regulations have changed the way they run their banks. Instead of comprehensive loan officer training, many community banks have specialized areas within the loan function, including centralized loan underwriting with limited processors. As a result, community banks have increased staffing to absorb these additional responsibilities and maintain compliance.

Some bankers attest that the “centralization of the loan function is great at reducing compliance risk, but it detracts from the community bank model.”

One community banker stated that his bank spent \$100M in salaries alone to maintain compliance with regulations, which does not include technology infrastructure or third-party contracts. While staff additions are the common response from Mississippi community bankers to achieve compliance, many indicated that increased reliance on third parties is also a byproduct of the current regulatory environment. Third-party relationships include information services, attorneys, independent auditors and accountants. Increased staffing and third-party services have marginalized bank earnings. Because this established infrastructure must be maintained to ensure ongoing compliance, Mississippi community bankers say that they can't reduce compliance costs.

While bankers agree that the current compliance examination process is adequate, they believe that it can be improved by using field examiners local to Mississippi or bank market areas. Additionally, some stated that exam findings should outline proper practices and procedures for any cited

violation, which would give better direction for correction.

Mississippi community bankers state that they are being asked to police anti-money laundering regulations. As a result, there is an inherent fear of missing something, which has led to an increase in Suspicious Activity Report filings. Potential civil money penalties for noncompliance add to the current level of anxiety among community bankers.

Small Business Lending

Pressures from large regional banks are impacting Mississippi community banks' small business loan growth. In the agriculture markets, the FCS poses the greatest threat to community bank loan volumes. One banker stated that because of the FCS's competition, the bank is losing its best loans. His bank has an average loan portfolio of \$72 million, and he stated that he lost over \$4 million in loans to the FCS over the past five years. Bankers stated that they “simply cannot compete.”

Management Structure/ Succession/Human Capital

The difficulty in attracting and keeping quality staff is more pronounced in rural areas than in metropolitan areas. In urban areas, community bankers are able to attract

talent from large regional banks, while bankers in rural locations primarily rely on word of mouth and university and industry contacts. Many community bankers stated that overall employee turnover is low, but they are experiencing a higher level of turnover in the nonmanager and entry level positions. One banker stated that the average tenure of his employees is 18 years.

Community banks located in rural areas or banks with a single branch location said they faced some challenges in attracting sufficient talent for the future leadership of the bank.

Specialty positions in the areas of compliance, information technology, the BSA and loan review are more difficult to fill. Attracting employees poses a challenge for community bankers; however, staff retention is stable. Mississippi community bankers stated that connections to the community are a vital component of employee retention. Moreover, they feel that career opportunities within the banks, compensation and employee training remain desirable workplace attributes.

Training opportunities vary from more formalized graduate degree programs to webinars and on-the-job management training programs. One community banker stated

that he is unable to offer high salaries but can offer extensive employee training. The value added through training opportunities better aligns employee compensation with other community banks'.

The takeaway from Mississippi community bankers is that they will continue to provide banking services regardless of the regulatory environment, competitive pressures and changes in the banking industry dynamic. Their actions and their banks' involvement both stimulate and stabilize the economy of each area they serve. As intentional community advocates, community banks provide not only financial services, but, in some cases, life skills to members of the community. In summation, one banker stated, “We are ‘all in’, and the same cannot be said for large regional banks.”



Market Conditions and the Local Economy

Missouri bankers expressed concerns that falling farm commodity prices may place constraints on agriculture borrowers' capacity to meet their obligations. Furthermore, bankers are monitoring agricultural borrowers' equity levels as many tap into these funds to meet operating costs.

Increased political risk and uncertainty tied to the 2016 presidential and congressional elections were highlighted as concerns.

Missouri community bankers expressed a host of operational risk concerns, including rising levels of data breaches and debit card fraud. Where there are breaches or fraudulent activities, bankers—instead of vendors—often assume the cost associated in replacing debit cards for consumers, regardless of fault.

Missouri bankers have observed the benefits and challenges tied to full employment. As the labor market tightens, Missouri bankers are struggling to attract and retain talent, especially in more rural areas.

Current Regulatory Environment

Missouri bankers expressed concerns with regulatory oversight of both their income producing and nonincome producing activities. The most

time-consuming regulations cited include the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA), the TILA-RESPA Integrated Disclosure form (TRID), the Bank Secrecy Act (BSA) and Home Mortgage Disclosure Act rules. Some bankers have encouraged local real estate sellers not to write contracts with 30-day closings. Appraisal regulations were also highlighted as having an impact on bankers' income producing activities. For example, one banker noted that despite the costs associated with the appraisal requirement, valuable information is seldom received from the process. Instead, the banker noted delays in decision-making and lending due to the appraisal requirement.

One Missouri banker expressed an interest in entering the small-dollar lending space, but noted it remains unprofitable under current regulations and will likely remain so under the Consumer Financial Protection Bureau's proposed rulemaking. A Missouri banker shared an anecdote from a community development institution that attempted to provide small-dollar loans with APR rates of 36 percent, yet dropped the product because of little profitability under the current rules.

There were also some regulatory concerns tied to nonincome producing activity. A number of bankers expressed concerns that the Department of Labor's overtime rule would create costs and complexities for human resource operations.

Missouri bankers expressed concerns that the compliance examination process tends to be adversarial instead of collaborative. One banker suggested clarity from examiners on when a referral to the Department of Justice is required.

Small Business Lending

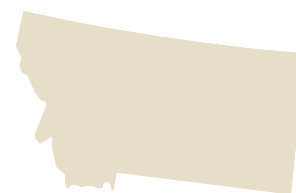
In the small business lending space, Missouri bankers consistently mentioned heightened competition from the Farm Credit System and credit unions. The Farm Credit System in Missouri has significantly expanded its membership base beyond farmers and is beginning to resemble traditional commercial lenders. Though there is some competition from online lenders, their impact is hard to measure in Missouri.

Management Structure/Succession/Human Capital

Missouri bankers expressed the most concerns about attracting talent to their rural branches. It is difficult to attract the most qualified

individuals, and the need to assist spouses with finding employment during relocation compounds the challenges. Furthermore, given the transient nature of today's workforce, it's hard to retain employees for more than five years if they do not have a clear path toward senior leadership.

Missouri bankers train their staff by drawing on a host of different resources. Many utilize webinars, in-house sessions and state banking schools (e.g., Barrett School of Banking).



Market Conditions and the Local Economy

Though the U.S. economy expanded in 2015, Montana was one of a handful of states that saw its economy contract last year. As in other rural states, Montana's local economies continue to feel the negative effects of falling agriculture and energy prices. Furthermore, the closing of coal mines and power plants has had a significant impact on economic stability.

Similar to last year, Montana bankers continue to face significant competition from financial institutions that are beginning to fill spaces originally occupied by community banks. Additionally, community bankers in Montana feel greater pressures to consolidate as the population of rural communities continues to decrease.

Current Regulatory Environment

Montana's community bankers listed residential mortgage regulations, appraisal requirements for real-estate related transactions and anti-money laundering rules as the regulatory areas where their compliance officers spend the most time. In order to ease regulatory burden in these areas, Montana's community bankers suggested raising

dollar thresholds for real-estate transactions that require appraisals and for transactions that trigger Bank Secrecy Act currency reporting. Some rural banks in Montana are exiting the residential mortgage space due to compliance costs. One of the most challenging aspects about these rules, according to Montana's bankers, is the pace and breadth at which rules are proposed or amended.

Some of the recommendations that bankers have suggested to ease regulatory burden are: (1) exempting lenders with small mortgage portfolios from certain mortgage-related regulations that should be directed at larger lenders; and (2) refraining from issuing civil monetary penalties where entities are making good faith efforts to comply with the law.

Montana bankers also recommended reforms to the compliance examination process so that it becomes more valuable to bank management. Bankers suggested modifying the compliance examination culture so that it is more cooperative, corrective and instructive rather than punitive. These bankers also recognized that there are ways for them to cut compliance costs, including sharing services with competing banks and utilizing banking association resources.

Small Business Lending

Montana's bankers are facing the most competition from the Farm Credit System, equipment dealers and large banks that engage in lending through the Small Business Administration's loan programs. The bankers are facing less competition from online lenders that serve small businesses.

Management Structure/Succession/Human Capital

The bankers are experiencing difficulties with attracting qualified individuals, especially in rural areas. Information technology and compliance professionals are the hardest to retain. Difficulties with attracting and retaining talent have hurt succession planning. As a result, many bankers consider merger and acquisition deals as a substitute to implementing a succession plan.



Market Conditions and the Local Economy

Community bankers in New Hampshire are seeing significant variance in their local economies and housing markets. As a whole, the state is losing manufacturing jobs. New jobs are only emerging within the hospitality industry and service sector. Jobs in these sectors generally offer lower wages than those of the disappearing manufacturing jobs. The southern regions of the state are experiencing more growth than the northern areas. The housing market in many parts of the state is stagnant, despite lending pipelines that have reached capacity. In some areas, such as Sullivan County and the Seacoast Region, this is due to a lack of available inventory. Home values are increasing, but buyers cannot find properties to purchase. Appraisals are also posing challenges. Appraisers are using comparisons that are stale, and bankers noted that the appraisal guidelines do not reflect current conditions.

Current Regulatory Environment

Community bankers in the state are struggling to continue business as usual when faced with burdensome and time-consuming regulatory compliance requirements. New and changing consumer

regulations have limited the ability of community banks to provide flexible solutions to their customers. Multiple bankers said that their technology has not been able to keep pace with new disclosure requirements for mortgage lending. New technology also is very expensive to implement. When it comes to disclosure and reporting requirements, bankers feel that there is a very low tolerance for mistakes. One banker noted that if a mistake is made on a disclosure statement within the appraisal process, the bank must provide restitution to the customer. The Home Mortgage Disclosure Act (HMDA) was another area that bankers noted was burdensome with high costs and limited room for error. One banker stated that he has three full-time employees for HMDA reporting, and the bank does not see the value in the reporting process. Increased time and energy dedicated to compliance has resulted in delays in the closing process. Bankers interviewed agreed regulatory burden has pushed banks to provide standardized products and services, except in the commercial lending space.

Bankers also pointed to inconsistencies in supervisory findings and ratings across regulators. Bankers noted that there is a lack of consistency in

what examiners consider to be best practices. Receiving different messages from multiple regulators creates confusion and uncertainty, and bankers do not feel that contributions to their communities are being recognized. One banker said that, with regard to compliance exams, regulators are using their banks as a training ground, educating their exam staff while consuming the bank's time and resources.

Small Business Lending

Community bankers in New Hampshire are seeing increased competition in small business lending from credit unions. Often, credit unions are making loans that banks are not willing to make. One bank noted that the riskiest commercial loan on their books was refinanced by a local credit union. Another banker mentioned that most local real estate companies have in-house lending, in addition to their own appraisers and title companies. Customers are being told that they have to use the in-house lender, and bankers interviewed felt that this was steering. When it comes to other potential sources of competition, one banker interviewed stated that her bank has found partners in "fintech," or financial technology firms. The relationship with online players has so far

been complementary, rather than competitive.

Management Structure/Succession/Human Capital

New Hampshire's community bankers are struggling to attract new employees. Bankers interviewed noted that millennials are not drawn to banking careers. One banker is partnering with a local college to attract students. Demand for commercial lenders is very high, but qualified lenders are difficult to find. Often, banks put a lot of money and time into training new employees, only for them to leave to another institution where they are offered a better salary. This has resulted in banks bringing in new employees at higher salaries than were previously offered. However, when new employees are hired at higher wages than current employees', it causes discontent among existing staff. For this reason, banks are being forced to increase compensation across the board in an effort to retain good employees. Bankers also described encountering difficulty stemming from the new U.S. Department of Labor regulations. Due to the overtime rules, banks increasingly have to move salaried employees back to hourly jobs.

Market Conditions and the Local Economy

When asked about the most concerning local, regional or national issues, New Mexico bankers from both metropolitan and rural areas came back with two main issues: the economy and regulation.

As a largely rural state relying on natural resources such as agriculture and energy for income production, the more-volatile commodities markets have taken a toll on large portions of the state. Additionally, New Mexico experienced slow recovery from the Great Recession compared to neighboring states. Several banks with branches in other states noted more robust economies helping to provide additional opportunities for lending. Almost universally, New Mexico bankers said that businesses in their communities lack the confidence to borrow, invest or otherwise extend themselves financially.

Current Regulatory Environment

The continued regulatory burden, businesses' lack of confidence for borrowing, volatility in the commodities markets and a prolonged period of extremely low interest rates continue to place downward pressure on community banks' profitability and, in some cases, viability.

Bankers cited a combination of both the disproportionately heavy regulatory burden placed on community banks and a lighter, or lack of, regulation for nonbank competitors as a concern. As one banker stated, "The emergence of nonbank competition and the lack of oversight and regulation

allowing them to compete in the financial sector at a much more efficient level remain a huge concern for community banks." Another banker described it as a "lack of equitable treatment between different providers of the same product: online lenders, tax exempt financial institutions, etc."

New Mexico bankers expressed concerns about the frequency of examinations, heavy requirements for documentation and procedures, Bank Secrecy Act rules, flood insurance regulation and fair credit, culminating with a sweeping statement that "Dodd-Frank needs to be repealed as it pertains to community banks." Community bankers agree that many new "consumer protection laws" are having a negative impact on access to credit. While some issues with compliance related to newly enacted or changed laws, the most vigorous complaints were focused on "new" interpretations of existing laws.

Regulations are impacting the products and services offered, most notably for home mortgages. The impacts include debates on whether to continue offering 1-4 family mortgage products, or to significantly scale back or entirely eliminate this type of real estate lending due to compliance challenges. One banker identified additional consumer harm, saying, "The new mortgage requirements have removed community banks from doing home loans. The ability and desire for community banks to assist their customers in mortgage transactions is greatly diminished. This is to the detriment of the community even more than to the bank."

More than one banker expressed frustration with regard to one of the "big bank's" local offices placing long holds on the community bank's cashier's checks, which the banker said was clearly in violation of Regulation CC. Additionally, community bankers are often frustrated with what they say is the lesser, or complete lack of, regulation of nonbank entities and an unlevel playing field. Also, they said there was a need for streamlining documentation with regard to internal proof of compliance as well as assisting customers.

Small Business Lending

While competition from commercial banks, credit unions, savings associations and mortgage companies has been around for years, banks are noticing increased competition from online lenders, consumer finance companies, the Farm Credit System (which is also creeping into nonfarm lending), equipment manufacturers and other captive finance entities, private equity groups and other investors. In addition, credit unions have begun taking on small business lending, "much to [the] detriment of community banks." It seems to community bankers as though competition is coming from every direction, and they feel at a disadvantage.

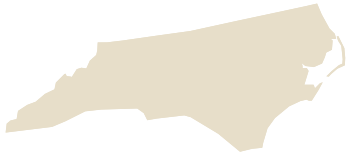
Management Structure/Succession/Human Capital

The ability to attract and retain employees largely depends on the size of the market the bank is operating in. Some banks have either outsourced specialties—such as information technology and compliance—or



have set up back office locations in metro areas. New Mexico bankers' ability to attract talent is challenged by population shifts to metro areas. One banker explained it best by saying, "It is more difficult to recruit in a rural area versus larger metro areas for bankers and professional people of all types." The banker noted that the bank made a strategic decision to outsource most of its information technology functions as a result. New Mexico bankers also find it difficult to attract quality commercial lenders.

New Mexico bankers expressed concerns that a lack of financial literacy creates challenges with consumer engagement and attracting qualified employees. As one banker stated, "Financial education needs to begin early in all communities. Frankly, the fact that basic financial education is not a core element required of any high school graduate is one of the major problems affecting financial literacy." Yet another made the observation, "The consequences of this lack of financial education are compounded by a very cyclical economy." When it comes to training staff for all areas, there are a variety of strategies. These include in-house and online training (used because of budgetary constraints), along with banking schools, conferences and university training where available.



Market Conditions and the Local Economy

While there is limited loan growth in rural areas, bankers in metropolitan areas have reported strong growth. One banker attributed economic constraints in North Carolina's rural markets to both job and population losses. Nonetheless, some bankers worry that the multifamily lending market in metropolitan areas is overheated.

Despite growth opportunities in metropolitan areas, North Carolina bankers expressed concerns with the low interest rate environment and increased competition from nonbank competitors. There are concerns that nonbank competitors are relaxing lending standards, while it is becoming more difficult for traditional community banks to serve consumers—many of whom have not witnessed significant wage growth in recent years. A community banker noted that the bank's recovery from the financial crisis continues to lag two to three years behind its largest competitors'.

Current Regulatory Environment

The Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA), the TILA-RESPA Integrated Disclosure form (TRID) and

qualified mortgage and anti-money laundering rules were cited as the most burdensome regulations for North Carolina bankers. Dodd-Frank's consumer-related rules against unfair and deceptive practices also were called unclear.

These bankers recommended a number of regulatory fixes that would ease the burden, including increasing Currency Transaction Report thresholds and simplifying various reporting requirements, including those under the Home Mortgage Disclosure Act. Furthermore, North Carolina bankers expressed concerns with various accounting rules, including the Financial Accounting Standard Board's Current Expected Credit Loss (CECL) standard.

North Carolina bankers expressed concerns about the punitive nature of compliance examinations and the complexity of regulations. North Carolina bankers are limiting their compliance risk exposures by pulling out of certain business lines. For example, bankers reported reducing their mortgage and consumer loan portfolios. Instead, bankers are concentrating on commercial lending, where the regulatory burden is lower. One bank said that it delisted from the exchanges to minimize regulatory costs. Another bank is considering sharing

Bank Secrecy Act and compliance services with similar banks to cut costs and improve efficiencies.

Small Business Lending

North Carolina bankers are experiencing increased competition from nonbank mortgage lenders, online lenders providing commercial loans, credit unions and larger regional banks. One banker noted that there may be increasing levels of risk-taking associated with Small Business Administration loans as banks hold greater levels of unguaranteed portions of loans.

Management Structure/Succession/Human Capital

North Carolina bankers are devoting a significant amount of time and resources to training employees. Many firms provide in-house and external training (including online) for their employees and directors. Banks have experienced more challenges with board succession than management succession. Furthermore, attracting and retaining talent appears to be more of a challenge for rural bankers. Resources are being devoted to succession planning, with one North Carolina banker noting that succession is discussed at least every six months on the board level.



Market Conditions and the Local Economy

North Dakota community bankers report a growing concern regarding commodities both in the agriculture and oil and gas sectors. As oil and gas prices continue at their historical lows, combined with low farm commodity prices and drought in certain areas of North Dakota, bankers are uneasy about some of the borrowers' abilities to repay their loans. At the same time, builders continue to oversaturate the multifamily housing market, and new bank competitors are appearing all the time. Bankers feel like they are being squeezed from both directions.

Of paramount concern to North Dakota community bankers is that Congress become more productive. The inaction inside the Beltway worries some community bankers, who see the upcoming election deciding what sort of regulatory relief they will ultimately receive.

Current Regulatory Environment

North Dakota community bankers struggle most with consumer regulations. Consumer compliance regulatory costs are limiting their competitiveness. Many times, they feel as though their banks spend an enormous amount

of time preparing a single consumer loan, yet consumers barely even glance at the disclosures. Regulations need to be simplified so that bankers and consumers are more empowered when lending and borrowing.

The upcoming Current Expected Credit Loss model is a concern for community bankers.

When it comes to compliance exams, North Dakota community bankers would like to see steps to make them more like safety and soundness exams. Regulators need to "onboard" banks, getting out in front of regulations and helping banks understand how to be in compliance.

Small Business Lending

Bankers are increasingly concerned that there is not a level playing field when it comes to competition in small business loans. Virtual lenders and credit unions both have fewer regulations to comply with. Community bankers already face stiff competition with one another, but when you add on peer-to-peer lenders and credit unions, it becomes challenging to post a profit.

Management Structure/Succession/Human Capital

For North Dakota community bankers, management succession is most challenging

in rural areas. Agricultural lenders are very hard to attract and retain, considering the stressful nature of the compliance work associated with lending. Some bankers note that it is hard to get applicants in rural areas for even lower-level positions. One community bank did not receive a single application for its opening for a head cashier.

Other North Dakota banks, however, report that hiring is the strongest it has ever been. One bank looks to hire college students part time and grow their talent, reach out to the local community at public gatherings and customize work schedules. Another bank notes that it has been successful in hiring because it uses its bank trade association to find applicants and educate its current staff.



Market Conditions and the Local Economy

Ohio community bankers expressed concerns about the changing customer base. One banker stated that the top two issues in Ohio are “the overall changing mentality of the customer base, with the majority being interested in mobile transactions over [financial security].”

Ohio’s loan growth is moderate to strong. However, capacity at smaller institutions continues to be a concern, as they are struggling to close larger and more complex deals.

Current Regulatory Environment

Generally, Ohio community bankers are looking for more guidance as to how to comply with new regulations coming out of Washington, D.C.

The Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the TILA-RESPA Integrated Disclosure Rules (TRID) are concerns for Ohio community banks, and many community bankers are waiting for more information on what TRID compliance examinations will look like. One community banker commented that TRID is “taking away the uniqueness of institutions and creating a culture with no opportunity to make decisions.”

Fair lending regulation is also a concern, as it is causing indirect lending. Ohio community bankers also expressed concerns about the Bank Secrecy Act (BSA) and noted that “some institutions are increasing BSA staff due to increasing regulations.” BSA compliance is considered expensive and time-consuming.

Commercial real estate lending is also a concern. Commenters were concerned about upcoming regulations, specifically, future capital requirements.

Small Business Lending

One respondent noted that community banks are experiencing competition from online lenders such as Quicken and Lending Tree, as well as from credit unions. Community bankers noted that borrowers are going to commercial real estate brokers and that larger institutions are lowering their underwriting standards on commercial and industrial and commercial real estate loans. These alternative options are more attractive to borrowers because, according to one banker, “they can process the loan much quicker than banks can.”

Management Structure/ Succession/Human Capital

Ohio community bankers emphasized that it is difficult

to find and retain talent, and especially difficult to attract talent to more rural areas. One community banker commented that the emphasis on his institution is “professional development, leadership development and succession management.” Specifically, the Mansfield and Springfield county markets have been particularly challenging, and a lot of energy has been focused on developing talent there, bankers said. Generally, internships have been very helpful in attracting talent.

Market Conditions and the Local Economy

Oklahoma bankers are primarily concerned about local and regional commodity prices and the impact they have on their local communities. Some towns, like Guymon, rely heavily on the commodity market. Should historically low prices continue, bankers believe many farmers will have to liquidate, and the entire community could be in jeopardy.

Low energy prices have also harmed local economies. Several small towns rely on the energy industry to employ their citizens. Accordingly, Oklahoma bankers worry that towns will see an exodus if there is a decline in employment. This could impact real estate values, service companies and small business owners, all of which are bank customers.

Low energy prices have also severely impacted Oklahoma's budget. The state economy relies on energy companies for tax revenue, and low prices have led to diminished revenue for education, infrastructure and elderly care. One of the outcomes of a poorly funded education system is inadequate financial education in Oklahoma schools. Some bankers fear that Oklahoma is at risk of turning out citizens who are underqualified to compete in the job market of the 21st century.

Current Regulatory Environment

Oklahoma community bankers feel like they are oftentimes the first to be punished for actions of other entities in

the financial services industry. For example, abusive payday loans to military members resulted in the Military Lending Act. One banker reports that their bank makes approximately 25 percent of its loans to military personnel, but incurs a cost on all loans to verify whether the borrower is covered by the Military Lending Act. Oklahoma bankers feel that the Dodd-Frank Act is similar to this. Community bankers are feeling the brunt of new regulations enacted to curb the practices of the largest banks. The Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the TILA-RESPA Integrated Disclosure form (TRID) process is one of the largest concerns for community bankers. Oklahoma community bankers recommended that the Consumer Financial Protection Bureau—through its rulemaking—further differentiate between small community banks and the nation's largest banks.

One banker, who formerly served as an examiner, asked that supervisors consider making regulations for community banks specifically. "Having to play by the same rules as [the largest banks] is not even close to being fair or possible," said the banker. "How can a bank in [my town] expect to comply or understand all the new compliance and IT laws? How can our risk and complexity profile be the same? Lending is now regulated not by the 5 C's of lending but by compliance."

Oklahoma bankers also expressed concern about increased requirements for bank equity capital, the

expansion of the Home Mortgage Disclosure Act and the effect of the overall aggregation of regulations on community banks.

Small Business Lending

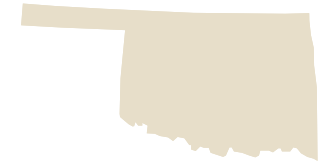
Oklahoma community bankers struggle to compete with credit unions and the Farm Credit System. Both present a real threat to the banks' ability to lend at a fair rate, since both of these institutions are tax-exempt. Some bankers feel that credit unions' seeking more member business loan authority is unfair to community banks, as these loans are outside the original tax-exempt scope of credit union business.

Virtual lenders have also been a growing presence in Oklahoma. One banker notes that, testing out virtual lending systems, the bank has found that it is able to get pre-approved for large loans with no collateral at rates lower than market value. Since these lenders are less scrutinized, investors are able to more freely put money into the system and see their investment as a calculated risk.

All of the new competition points to a growing concern that young consumers are leaving the traditional lending system. Young consumers in Oklahoma have told bankers that, if they can't get a financial service on their phone, they simply won't use it.

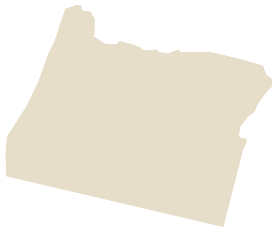
Management Structure/Succession/Human Capital

Oklahoma bankers struggle to retain human capital, especially in information technology and compliance. Very few



candidates have a law degree and the requisite experience to understand the regulations being produced or to develop policy that will be in compliance. In the future, Oklahoma community banks see continued difficulty in hiring for technical positions.

To build human capital, Oklahoma community bankers utilize on-site training and reach out to trade associations for assistance. To retain employees, Oklahoma community bankers are building preplanned career paths for their employees to motivate them, providing extra vacation time and incorporating more flexibility in employee work schedules. One bank provides a bonus six-week sabbatical every five years to its employees.



Market Conditions and the Local Economy

Oregon bankers generally feel good (but not great) about the economy. The state's economy is benefiting from growth in industries such as computer software, specialty manufacturing and breweries. Home prices, especially in the larger cities, have risen significantly and continue to rise due to the improving economy and related job growth, significant in-migration and limited supply of homes. On the downside, banks that have significant agricultural exposure are starting to get concerned about the possibility of a protracted slump in agricultural product prices. Also, some Oregon bankers are starting to see signs of a real estate bubble with housing affordability, or whether to rent or purchase, becoming a real concern. While residential and commercial construction activity has picked up, a shortage of construction workers is causing some projects to stall or get delayed.

Oregon bankers expressed concern regarding Initiative Petition 28 (Measure 97), a proposed measure which, if approved by voters in the coming election, would raise taxes for larger businesses. They strongly believe that this will have a significant adverse impact on business in general and may even prompt some

businesses to leave the state, which in turn will negatively impact the state's economy and banks. Other concerns include the protracted low interest rate environment, political uncertainty, gridlock in Congress and excessive regulation.

Current Regulatory Environment

Oregon bankers consistently indicated that the Bank Secrecy Act (BSA) was an area where the cost, time and effort to ensure compliance have increased significantly. Bankers expressed frustration with compliance and reporting requirements related to the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the TILA-RESPA Integrated Disclosure form (TRID). The Current Expected Credit Loss Model (CECL) and capital rules stemming from Basel III also appear to be causing bankers some angst. While BSA-related rules and regulations have not changed, regulatory expectations around BSA seem to have increased, Oregon bankers said. The bankers went on to say that examiners seem more focused, and are spending more time, on reviewing BSA compliance, resulting in an increase in the volume of findings and recommendations, even though banks are not

doing anything differently than they had been doing previously. The increase in the volume of findings and recommendations is resulting in banks needing to dedicate more resources toward BSA compliance and is directly affecting the bottom line. Bankers' estimates of the increase in the cost of compliance (exclusive of the increase resulting from the institution's increased size) ranged from 50 percent to 150 percent in recent years.

Oregon bankers say clearer directions are needed from the Financial Crimes Enforcement Network (FinCEN) in connection with banks' direct and indirect relationships with marijuana-related businesses (MRBs). Despite the issuance of the Cole Memo, banks are still very wary of doing business with MRBs because of the lack of certainty and clarity regarding the federal government's position on the subject.

Several bankers indicated that they are reluctant to make mortgage loans because of current regulatory requirements, but continue to do so only as an accommodation for their customers who might have difficulty getting a conforming loan elsewhere. One banker indicated that his bank has completely exited the business of making mortgage loans.

Call report preparation is very burdensome for a small

bank with limited resources. Oregon bankers strongly feel that a one-size-fits-all approach toward regulation is seriously flawed and gives larger banks a major competitive advantage.

Oregon bankers would like to see an increasing portion of exams being done off-site with the end goal of reducing the amount of time examiners spend at the bank. Regulators should consider increasing the 1.25 percent limit on the loan loss reserve that is counted toward Tier 2 capital particularly since CECL is expected to generally result in banks needing to maintain higher loan loss reserves.

The focus of the compliance exam should be on helping banks to comply rather than on trying to find rare or trivial instances of noncompliance, and then coming down hard on the institution. Oregon bankers said there needs to be a recognition among examiners that most bankers want, and are trying their best, to do the right thing, and that ensuring 100 percent compliance with the myriad of laws and regulations, many of them extremely complex and hard to understand, is almost impossible. Examiners need to take a more reasonable approach. Examiners need to use more judgment and be more flexible instead of simply resorting to strict interpretation of rules

and regulations. One banker complained about the time it took for the examination report to get issued (six months) after the field exam had been completed. The length of the pre-exam questionnaire/request list should be reduced. Bankers remain concerned about the trickle down impact of rules promulgated by the Consumer Financial Protection Bureau for large banks. Bankers feel the benefits of a compliance exam are minimal relative to the time and effort expended on the exam by both the bank and the regulators.

Small Business Lending

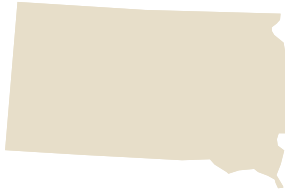
Oregon bankers are presently not really competing with alternative lenders and fintech companies. Banks are not too interested in lending to the types of customers that are being targeted by these firms. However, one banker felt that millennials that are becoming business owners may prefer these lenders over banks because of the speed and convenience of online lending processes. This could become an issue for banks in the future.

Oregon bankers expressed significant concern regarding competition for business loans from credit unions and the Farm Credit System, both of which are perceived to have unfair advantages. Small banks

are also facing stiff competition from larger regional and national banks that seem to be lowering their size thresholds for business loans and are offering more liberal terms than the smaller banks can offer.

Management Structure/ Succession/Human Capital

Despite the merger activity in the industry, there is a shortage of experienced and qualified bankers. Attracting talent is becoming increasingly difficult. However, retaining employees has not been as challenging. Executive level positions are difficult to fill, especially in nonmetro areas. Many recent executive level positions have been filled by out-of-state candidates. Good loan officers are extremely hard to find. There also appears to be a dearth of talent for specialty positions, such as in information technology, compliance and operations. Because of the shortage of talent, compensation levels for these positions have also increased significantly.



Market Conditions and the Local Economy

The primary economic driver in South Dakota is agriculture. After years of steady growth and high returns, commodity prices have moderated and cash flows have tightened. The tightening of the market has had an impact on farmers, equipment dealers, feed and seed suppliers, and on the community banks that service them.

South Dakota bankers are concerned about the indirect impact of agriculture on other businesses, about changing weather patterns, about shrinking populations in rural South Dakota and about the national regulatory environment. South Dakota bankers are also concerned about the impact the oil bust in North Dakota is having on their customers.

Current Regulatory Environment

South Dakota bankers are concerned with the growing regulations behind residential real estate lending. The increasing number and complexity of disclosures has driven up costs and slowed the lending process, ultimately causing several banks to leave the business entirely. South Dakota bankers expressed concern that the need to continually train employees

about ever-changing regulations takes time and energy away from consumers and businesses.

South Dakota bankers recommended easing the compliance burden for residential real estate and related appraisals. Specifically, bankers argued that the requirement to redisclose any Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the TILA-RESPA Integrated Disclosure form (TRID) changes—no matter how small—significantly slows the lending process. Accordingly, South Dakota bankers recommended that regulators prevent the new Home Mortgage Disclosure Act rules from being implemented for community banks and remove the three-day waiting period after delivery of disclosures to consumers.

South Dakota bankers expressed appreciation for recent changes made to compliance examinations to make the process more risk-focused.

Management Structure/Succession/Human Capital

The ability to attract and retain employees can vary by city and region in South Dakota. The biggest challenge for rural banks is the ongoing depopulation. One banker was said to have 15 nieces and nephews, yet all of them live

in a metro area instead of their hometown.

Of all staff, lenders can be the most difficult to retain. Lenders need specialty experience in agriculture, and these individuals are in high demand. Beyond lenders, it is also difficult to attract compliance, information technology and Bank Secrecy Act specialty employees.

One South Dakota banker noted that banking is no longer the desirable career choice it once was in many rural communities. South Dakota bankers expressed challenges filling all positions, regardless of skill-level. Some banks have decided to train employees within the bank for specialty positions. Promoting someone who is already established in the community, has expressed a desire to stay with the company and is familiar with the bank appears to be less risky than hiring from outside the bank.



Market Conditions and the Local Economy

Tennessee community bankers are seeing remarkable improvement in the state's economy, which is growing faster than the national pace. They remain committed to the state's rural communities.

However, Tennessee bankers have concerns about the real estate market becoming overheated, a prolonged low-interest rate environment and the indecisiveness of Congress. As one banker put it: "Will the national debt ever be handled? Will the federal government ever tailor regulation differently between small and large businesses?"

They agree that teaching consumers about banking at an early age could help end the cycle of poverty for some families. Bankers find that most young adults and new customers have very limited knowledge of personal finance. This also is a generational problem: Older consumers often lack the requisite skills to manage their finances.

Current Regulatory Environment

Tennessee bankers spend an inordinate amount of human resources, money, time, energy and mental stress on compliance. They said regulations are unclear and constantly shifting. The introduction of

the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA), the TILA-RESPA Integrated Disclosure form (TRID), the constantly changing requirements of the Bank Secrecy Act, fair lending compliance issues and the Home Mortgage Disclosure Act (HMDA) all add frustration and fear of being penalized for unintentional errors, according to the bankers.

One banker noted that more time and money are spent on compliance than on business development or on enhancing customer services. "We put so much energy and man hours into being perfect that it destroys our real purpose of serving customers and meeting the community's needs," the banker said.

The most difficult aspect of regulations for bankers is the pace at which rules change. They ask that Congress and regulators provide more clarity and forward guidance.

They also report that, given the current regulatory environment, it has become more challenging to reach out and assist the unbanked and underbanked. When bankers consider a new product or service, compliance is the first topic of consideration, even above customer demand.

To address this, bankers recommend broad exemptions

for small banks. The smallest institutions are expected to maintain the same level of compliance as a large bank, but with fewer resources.

Bankers find value in safety and soundness examinations. Strong, productive relationships cause these exams to feel more cooperative. Compliance exams, on the other hand, feel more like attacks on the institutions and can be counterproductive. They want to see compliance exams be more constructive than critical.

Employees are fearful because one mistake on their part could have long-term consequences for the bank. Federal regulators should clearly state their mission and intent for certain rules. This would clearly set the tone for a better working relationship for all. Also, federal examiners should be clear as to what the bank will be tested on and how it will be measured, the bankers said. "If bankers do not fully understand the intent and purpose of the examination, how can they properly prepare, even though they spend many hours in an attempt to prepare blindly?"

Small Business Lending

The Farm Credit System (FCS) is the top competitor to Tennessee banks for small business lending. Because of low-cost funds and lower

compliance costs, FCS can undercut banks. Beyond FCS, credit unions and online lenders present new competition.

Management Structure/Succession/Human Capital

Attracting human capital is a significant challenge, especially in the more rural areas. Staffing at the branch level continues to be a trial.

Employing high school students as summer interns has served as an effective way to build a bond between the bank and community. Once a prospective student was ready, the bank provided the education and training needed to fill a role. The Tennessee Bankers Association (TBA) is a key provider of training to banks. The Barrett School of Banking and the Southeastern School of Banking at Louisiana State University also are utilized. The TBA has established a young bankers' initiative that provides education programs to the next generation of bank leaders. Webinars, external vendors and in-house training are all options that are used.

In rural areas, salary appears to be the key to attracting and retaining staff. When vital staffers are found, bankers can also retain them by granting latitude for when and where they work.



Banks

The Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the TILA-RESPA Integrated Disclosure form (TRID) are a consistent concern among Texas bankers. On the topic of regulatory burden, one banker reported spending as much as \$150,000 on compliance. Other bankers reported that, on average, TRID delays closings by seven to 10 days. They also expressed concerns that TRID examinations are subjective in nature and that examiners have their own interpretation of what constitutes a violation.

Bankers cited the Home Mortgage Disclosure Act (HMDA) as especially burdensome. One banker commented that disclosures are far too detailed to be meaningful to customers and that “every comma, period, abbreviation and minutiae are regulated.” However, many bankers commented that HMDA was not nearly as demanding as it was initially.

Fair lending law also was consistently described as burdensome. Bankers noted that fair lending examinations are far too subjective in nature and that a bright line needs to be established that varies by the size of the bank. They commented that the Consumer Financial Protection Bureau

(CFPB) seems to “regulate by enforcement and not by regulation” and that regulation “by fear seems to be the theme.” One banker emphasized that consumers are being harmed by the regulatory approach to fair lending laws and that “scoring and documentation is actually causing consumers who do qualify and are willing to take the loan to pay more than before.” Qualified mortgages also present concerns to bankers, who commented that many banks are no longer originating mortgages because of the regulatory burden and that they do not make any “real money.” They noted that if a community bank holds the loan in its portfolio and assumes the risk, that loan should be seen as a qualified mortgage.

Bankers expressed concerns with current and pending rules related to small-dollar lending. Overall, they are not optimistic about rule-making by the CFPB and whether it will increase community bank entry into this lending space.

Thrift and Mortgage Lenders

Texas thrifts and mortgage lenders noted that housing affordability and availability are persistent issues. Rising property values are also a consistent problem. Texas mortgage lenders commented that closing information has to be passed around “12-15 times” and that

closing is made even slower because of the “three-day rule,” the requirement that the buyer receive the disclosure three days prior to the consummation of the transaction.

Texas mortgage lenders expressed concerns that customer identification rules damage customer relationships. For example, one Texas lender stated: “We have known our customers and new customers for a long time, and they don’t understand why we need so much information about them. They find it offensive.”

One thrift institution was said to be experiencing increased competition from a variety of sources, specifically from credit unions and marketplace lenders. Furthermore, online lenders seem to be the originator of choice for many small business loans.

As far as talent acquisition, Texas thrifts and mortgage lenders noted that information technology professionals are difficult to find, especially in rural areas. One commenter noted that training predominantly focuses on compliance, but that there is still a disconnect between what “trainers teach and what on the ground examiners know.” Overall, Texas thrifts and mortgage lenders did not indicate that talent acquisition and retention was a significant problem.

Market Conditions and the Local Economy

Bankers are concerned about what they described as an emerging housing bubble, stating that “it appears as though the price of land is getting back to 2006-2007 levels and is not sustainable.” The bankers noted that they are getting “significantly” increased requests from builders for speculative financing. One banker noted that there are declining trends in commercial real estate and an oversupply of multifamily housing.

A concern shared by bankers was a lack of financial literacy among consumers. It was emphasized that this lack of education cannot be solved with just a high school curriculum, or a few classes, but rather a statewide initiative is needed. One banker said, “The public does not understand banking, investing for retirement, owning a home, buying a car, budgeting, etc.”

Current Regulatory Environment

Bankers emphasized that there is not one particular regulation that is overly burdensome, but rather a combination of different requirements that are creating challenges. A banker said that none of the compliance regulations alone are excessively burdensome by today’s standards, but that in combination they are all excessively burdensome, “because we have to comply with all of them at the same time.”

Some bankers questioned whether regulations actually benefited consumers or instead caused them undue

harm and inconvenience. It was noted that Regulation B of the Equal Credit Opportunity Act should exclude commercial borrowers and that it is not necessary for a commercial borrower to receive the appraisal three days prior to closing because they are usually familiar with the property. Bankers also raised issues with the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the TILA-RESPA Integrated Disclosure form (TRID) requirements that enforce a mandatory waiting period on consumers. They said it’s costly, as many borrowers have to pay contract extension fees. One banker said, “TRID requirements should be done away with. The old disclosures and requirements were sufficient to handle 99 percent of the public.” The Consumer Financial Protection Bureau’s (CFPB) “Know Before You Owe” program also was seen as only minimally beneficial to consumers. It was noted that the depth and amount of information given to the consumer are overwhelming and cannot be informative.

Bankers feel that many regulations cut down on available credit, ultimately limiting consumer choice. For example, one banker said that deposit products are no longer offered, simply because the regulatory burden is too great. Many respondents reported having to discontinue products because of regulatory burden. One banker’s institution no longer offers, or in some cases only offers scaled down versions of, “private-education loans,

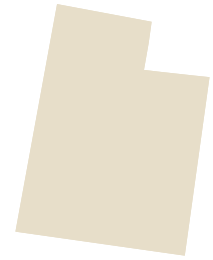
vehicle title loans, tax-refund anticipation loans, loans to service members, consumer foreign wire transfers, mortgage with balloon payments, credit life and disability insurance, etc.”

The Home Mortgage Disclosure Act (HMDA) also presents significant challenges to bankers. It was described by one banker as a “case of serious overreach and privacy” and a “boondoggle of information that has the potential to be scrutinized in minute detail by examiners.”

Some bankers saw compliance exams as inefficient and yielding little to no result. Another banker said that compliance exams simply take too long and that more work should be done before the on-site examination. They also stated that a “ranking” of compliance issues would be helpful and that a “tolerance level” should be applied to violations that are not willfully harmful.

Small Business Lending

Bankers have noticed a surge of competition in the small business lending space and are apprehensive about future CFPB regulation. Specifically, credit unions seem to be attracting small business borrowers. One banker lost “\$10,000,000 in business loans to credit unions.” Credit unions are able to offer lower costs because of tax subsidies and, according to one banker, “seem to operate without any limitations.” Larger banks also are entering this lending space through the use of credit cards that provide points or rewards to small business lenders.



Online marketplace lenders also present a challenge to community banks, and many small business borrowers are gravitating to online lenders. One banker said, “Online lenders who are not subject to the same regulatory constraints as banks continue to offer loans to our customers.” Bankers said online lenders offer a quick solution and aggressively advertise to consumers.

Management Structure/Succession/Human Capital

In rural areas, bankers shared that acquiring and retaining talent are difficult, especially information technology professionals. They noted that potential staff are no longer solely concerned with salary, but also consider benefits, promotion potential and workplace environment.



Market Conditions and the Local Economy

The slowly improving Vermont economy remains a concern for community bankers, who are searching and competing for quality lending opportunities. The state continues to experience a shrinking and aging population. The 2016 ALEC-Laffer State Economic Competitiveness Index ranked Vermont 49th out of 50 states on economic outlook due to the state's rating on 15 variables, including tax rates, labor policies and overall regulatory burden.

Bankers expressed concern about the future of conducting business due to many variables, including soft loan demand, rural markets that lack job opportunities and strong competition from out-of-state entities.

Current Regulatory Environment

Regulatory uncertainty impacts decision-making, resource allocation and strategic opportunities. It also resonates as an overarching concern for bankers. The Bank Secrecy Act, cybersecurity and overall compliance concerns require additional staffing, training, and reporting, all resulting in resources being reallocated from customer service and sales. One banker

noted increased regulatory requirements in the area of mortgage lending as a concern; the new “Know Before You Owe” regulation, in particular, has lengthened the mortgage loan application-to-closing timeframe.

Frustrations exist concerning the appearance of an uneven playing field for nonbank entities that offer loan products without the strict regulatory requirements financial institutions must abide by. Institutions are seeking an even playing field for all financial service providers. Regulatory relief across many areas for well-capitalized, healthy banks would assist Vermont institutions.

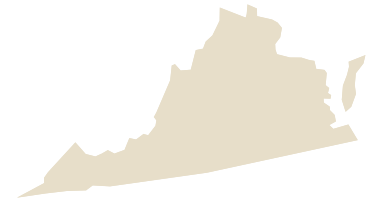
Small Business Lending

Small and micro businesses are prevalent. Fortunately, Vermont has nonprofit entities, such as the Vermont Small Business Development Center. These entities serve businesses that are not at the stage to be assisted by a local banking institution, but can utilize the assistance to prepare for future financing. These nonprofit entities strive to positively impact and strengthen both established businesses and startup entrepreneurs by providing a myriad of resources, ranging from seminars to one-on-one coaching to financing.

Management Structure/Succession/Human Capital

With the state's declining population and the industry's often perceived lack of “draw” for young people, bankers are motivated to develop programs to educate college students about the opportunities in the financial services industry. Initiatives—including seminars, panel discussions and internships—have been discussed and implemented in an effort to attract new employees.

Retention also is an area of concern. With many resources being allocated to specialized employee training, especially in the compliance and sales areas, it is very costly to lose well-trained and experienced employees.



Market Conditions and the Local Economy

Bankers expressed concern about job loss and how a lack of financial education affects the poor. They also expressed concern that credit unions have entered lending markets that the credit unions are not familiar with, such as construction financing.

The bankers also noted that the presidential election and its possible result have created uncertainty that has had a negative impact on business spending.

Current Regulatory Environment

The most time consuming and burdensome regulations to Virginia community bankers are: Dodd-Frank rules, the Home Mortgage Disclosure Act, the Bank Secrecy Act, the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA), the TILA-RESPA Integrated Disclosure form (TRID) and the Sarbanes-Oxley Act. The bankers said that both existing and new regulations are causing the most problems and that older regulations are no longer as meaningful or effective.

TRID was noted as particularly challenging, with one respondent commenting: “TRID is not understood

by the consumer and is not making the mortgage process more user-friendly. ... It is having the opposite effect of delaying closings and adding costs to transactions, not to mention frustration to the consumer.”

Bankers also noted that many of their products and services are “altered or not offered due to ever-increasing regulatory complexity and requirements.” They added that the consumer protections intended under Dodd-Frank are actually limiting choice and shrinking the pool of available credit. One banker emphasized that regulation is diminishing the original intent of community banking, writing: “The ability to assist customers with their unique needs is becoming more difficult. One of the fundamental features of a community bank is our ability to work with customers and determine a reasonable approach to meet their credit needs. Regulation continues to hinder our ability to take a practical approach in many situations.”

The Community Reinvestment Act (CRA) was also mentioned as cumbersome and outdated. One banker said, “CRA examination procedures have not changed materially for 15 years, yet the banking industry has evolved

tremendously, with many online banks and others now in the market.”

Small Business Lending

Online marketplace lenders are competing with community banks in Virginia. “The virtual players are grabbing market share and doing so in a nonregulated environment. This puts them outside of compliance reviews and regulatory mandates,” one respondent commented. Another banker compared the online lending marketplace with community bank lending, writing, “Virtual players are fueled by incredibly low pricing models, over promising services and products, and lack of regulatory oversight, while community banks continue to struggle with spread, stifling regulatory oversight, and ever increasing regulatory costs that make it more and more difficult ... to remain competitive.”

Bankers also have noticed increased competition in their local markets, specifically with credit unions and rural banks. Credit unions are becoming more prevalent in the small business lending market.

Management Structure/Succession/Human Capital

According to Virginia community bankers, there has been significant loss of

human capital as retirees leave the workforce. Information technology professionals are difficult to find and difficult to retain at a reasonable salary. Generally, bankers find that turnover is relatively low.



Market Conditions and the Local Economy

Bankers report an uneven recovery from the Great Recession. Four out of the state's 39 counties (including three of the most populated) are enjoying low unemployment rates and seeing economic growth, but the majority are experiencing unemployment rates that are above the national average. Bankers are particularly concerned about how the economic downturn is affecting the agricultural and timber industries. Hay farmers, wheat growers, dairy operators, cattle ranchers, and timber/lumber yard owners are being negatively impacted by the lackluster recovery and the strong dollar's negative impact on exports.

Bankers also have concerns about how \$15-an-hour wage initiatives will affect small business banking and how high demand and low supply of housing in specific counties may create a housing bubble. Additionally, they noted that national policy may be impacting the local economy. One banker said the "Federal Reserve's policy of prolonged historical low interest rates and the margin compression it has created for Washington's banks" is of particular concern.

Current Regulatory Environment

Bankers emphasized that, on average, Washington banks have a minimum of 0.75 full-time equivalents (FTEs) dedicated to Bank Secrecy Act (BSA) compliance. BSA compliance includes suspicious activity alert monitoring/research/documentation, BSA model maintenance/case management, and ongoing customer due diligence. Additional employee resources are dedicated to Currency Transaction Report and Suspicious Activity Report filing.

Bankers say that the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the TILA-RESPA Integrated Disclosure form (TRID) are cumbersome and ineffective. They found that despite "significant" time being dedicated to compliance, TRID does not accomplish its original goals. One banker remarked, "It is questionable as to whether TRID accomplished its original objective to simplify loan disclosures and make them more 'consumer-friendly.'" They also noted that parts of TRID, such as mandatory waiting periods, are inconvenient for customers.

The Home Mortgage Disclosure Act (HMDA) also

presents a challenge. Banks have a minimum of at least one FTE dedicated to HMDA reporting, as well as data integrity and filing requirements. They expect this burden to increase, as the HMDA amendments finalized by the Consumer Financial Protection Bureau (CFPB) add 20 new data fields to the existing 48 required per loan. There are apprehensions surrounding the use of new data fields and concerns about the potential for discriminatory lending practices.

Federal rules such as Dodd-Frank lending rules and current Federal Deposit Insurance Corp. regulations are of concern, as they are shrinking banks' mortgage lending activity. According to one banker, these practices are "forcing banks to drop historically good products, turn down borrowers or book less sound loans." Furthermore, "ability to repay" rules have reduced available credit statewide.

As far as a general feeling toward regulation, bankers believe that new/changing regulations are as burdensome as existing regulations. They also noted that the Financial Accounting Standards Board's Current Expected Credit Losses (CECL) standards will increase costs and be of little benefit to banks.

Bankers have noticed that UDAAP (Unfair, Deceptive, Abusive Acts and Practices) has affected whether banks can offer certain products or services. They commented that the “ambiguity in how it is applied and the subjectivity involved in determining whether a certain practice/product/service crosses the UDAAP threshold” have placed heavy burdens on banks. Often the choice to not offer a product or to alter terms and conditions to meet UDAAP standards is seen as “erring on the side of caution” and is preceded by significant research or deliberation.

Furthermore, the High Priced Mortgage Loan (HPML) rules and the Home Ownership and Equity Protection Act (HOEPA), and their treatment of fees (often included in the APR calculation), are making it more difficult to provide rural borrowers with smaller loans.

“Wholesale” funding is a large concern and it is seen as a necessary practice for banks to meet the lending needs of customers. National listing services, such as QwickRate or National CD Rateline, provide a national platform for banks to present their products to a diverse customer base. One Washington banker commented, “If a community

bank is able to raise deposits nationally on a more cost effective basis than it can in its local markets, this segment of deposits should not be viewed as an inferior deposit to someone walking into a branch.”

According to bankers, brokered deposits—despite not being favored by regulatory agencies—are beneficial for both the bank and the depositor. These deposits are a stable product, as brokered depositors cannot break the contract and withdraw their funds prior to maturity. Bankers emphasized that the current “call option” included in today’s contracts allows banks to return funds to depositors if it’s in the bank’s best interest to do so.

Small Business Lending

Bankers mentioned that online marketplace lenders present significant competition, specifically in small business lending. Credit unions also present a challenge, according to one commenter, as they are “using the credit union’s no-tax advantage to undercut the rates offered by banks in the same market.” To compete, banks are lowering rates, which is putting even more pressure on margins.

Management Structure/ Succession/Human Capital

Large segments of senior management are nearing retirement. One bank, within five years, will lose its chief financial officer, chief credit officer, treasurer, HR officer and two senior lenders. Rural banks also are finding it difficult to retain young talent, specifically, information technology professionals.



Market Conditions and the Local Economy

Overall, bankers view the local and state economies as good and getting better. The Wisconsin jobless rate (4.2 percent) is the lowest it has been in 15 years. The state has a high labor participation rate. Local businesses are showing a desire to add employees, although finding workers with the right skill sets and the ability to pass pre-hiring screenings remains a challenge.

Local residential real estate markets appear to have finally turned a corner, with sales volumes up and demand in most cases outpacing supply. Four of the five banks view residential mortgage lending as a strategic plank in their business models, albeit in different ways. The reasons for maintaining a sizable mortgage portfolio range from risk diversification to building customer loyalty to pairing it with wealth management services. Each of the four institutions cited that, while changing regulations continue to make mortgage lending more challenging, the institutions are willing to invest in those compliance requirements in order to maximize the opportunity and satisfy an element of their strategic plan.

Other sectors of the economy, such as manufacturing and hospitality, also appear to be strong. The agriculture sector is experiencing some struggles due to low commodity prices; however, one banker noted that the agriculture sector has always been cyclical in nature. The banker said the bank knows its customers well enough to protect the bank from potential losses.

Current Regulatory Environment

Bankers understand and support the need for regulations that protect consumers. However, they were unanimous in their view that the changing regulatory landscape has put banks at a distinct competitive disadvantage. In their view, regulations take too long to be implemented, are too complicated, are difficult to understand, and at times are applied in ways that can create uncertainty and confusion.

As one banker put it: “The concepts haven’t been wrong. It’s the implementation—it’s too complex and arcane.”

Some of the regulations cited as being the most time consuming and burdensome were real estate appraisals and evaluations, the Bank Secrecy Act, mortgage rules and changes to loan loss reserve

calculations. One banker noted that the proposed loan loss changes are expected to reduce capital levels with no concrete enhancement to smaller banks’ estimates of losses.

Examples of beneficial regulatory changes cited were extension of the examination cycle from 12 to 18 months, the JOBS Act of 2012 that allows banks that meet certain requirements to remove themselves from oversight by the Securities and Exchange Commission, and modifications allowing for a reduction in annual privacy notice mailings to existing customers. Changing privacy notice requirements saved one banker \$10,000 per year.

While all of the bank executives interviewed were generally accepting of the compliance costs they have already incurred, they also were wary that additional regulations will force them to invest even more, straining their profitability. They understand that compliance burden can have a chilling effect on new products and services. However, the CEOs also said that if a product or service is right for their market and customers, they will incur the compliance costs necessary to make that product or service available.

Small Business Lending

Large credit unions with widespread fields of membership continue to pose significant competitive challenges. Credit unions are offering lower rates for longer-term loans than banks are able to offer. Bankers believe this competitive threat will only increase as large credit unions continue to acquire smaller, more traditional credit unions with more narrow fields of membership. Wisconsin has more state-chartered credit unions with more than \$1 billion in assets (11) than similarly-sized state-chartered banks (four).

As one banker said: “We’re not afraid of competition, but a billion-dollar credit union operates just like a bank, but with a significant competitive advantage. ... It’s not a level playing field.”

Regional and national banks are also viewed as competitive threats by some bankers, as the larger banks often offer lower loan rates than community banks are able to offer. While those institutions have always been competitive for large-dollar loans, they recently have become more active on medium- and smaller-dollar loan originations, which traditionally have been a sweet spot for community banks.

In one case, the Farm Credit System also was viewed as a significant competitor. A concern raised is that the Farm Credit System not only enjoys a built-in rate advantage, but that some of its lenders are reaching into nonagriculture sectors, such as commercial lending.

None of the bankers perceive online lenders to be a serious threat in their local markets.

Management Structure/ Succession/Human Capital

Overall, bankers expressed comfort with their ability to attract the right people to their organizations, although they admit that recruitment and retention efforts must be a constant focus. Training is a key component of their efforts to retain good employees, in addition to being a critical piece of the institutions’ compliance efforts. One CEO noted that his bank has made it a strategic initiative to retain “specialty staff” (such as compliance and information technology).

The executives expressed confidence that they have adequate succession plans in place, although one CEO admitted his institution has a five-year window during which it will need to replace multiple members of the executive team, including him.

The CEOs all gave high marks to their boards of directors and said attracting new directors with the proper mix of talent has not been a problem. As one CEO put it, serving as a director on a bank board is still perceived to be an honor.



Market Conditions and the Local Economy

Wyoming bankers—regardless of their direct exposure levels—are grappling with the effects of the downturn in the energy markets, including those for coal, oil and natural gas. Banks with little direct exposure to the energy markets are being affected indirectly as their customers experience decreased economic activity and job losses. For example, sales of used vehicles decreased by 30 percent during the first two quarters of 2016, largely attributed to layoffs in Wyoming's coal industry.

Bankers expressed concerns with the state of financial literacy in Wyoming. One banker noted that a large swath of high school graduates do not have a good grasp of financial basics including balancing a checkbook, completing a loan application, and filling out a balance sheet.

Current Regulatory Environment

The most time-consuming and burdensome regulations cited by bankers include the Bank Secrecy Act (BSA), the Home Mortgage Disclosure Act (HMDA), flood insurance, the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the TILA-RESPA Integrated Disclosure

form (TRID). They are concerned that the current fair lending regime has constricted their lending and ultimately may limit consumers' access to credit. As one Wyoming banker stated, "Community bankers are increasingly asking themselves if any effort is worth it given the regulatory restraints. Regulation certainly has forced change in workflow. We are increasingly working for the regulators and not the customer." Another banker expressed satisfaction with TRID's usefulness to consumers despite the regulation's complexity.

Bankers believe the compliance examination process can be improved, calling for more examples of requested reports, more definite guidelines on regulations and more engagement with examiners. Current regulations may be pushing bankers toward more standardized products and services, which are contrary to the relationship-lending business model at the core of community banking.

As one banker put it, "A lot of our loans are specific to the consumer's need, and it is very difficult to provide them with their request and remain within the regulation. Therefore, our customers end up in a product that is more cookie cutter. Customization is what sets us apart from the

other banks in our area. If you take that away, the community bank's ability to survive in the financial arena, it will take away our competitive edge."

The Financial Accounting Standards Board's Current Expected Credit Loss standards are also a major concern to bankers.

Small Business Lending

Bankers are experiencing increased competition from the Farm Credit System and moderate competition from online lenders in the small business space. One banker noted that virtual competitors have been developing niches in this space, but are not major competitors. In that vein, bankers expressed that the overwhelming majority of their competition comes from the largest banks, regional banks and credit unions.

Management Structure/Succession/Human Capital

Bankers are investing resources in training their employees, often relying on on-site training, seminars hosted by banker associations and outside resources, like graduate banking school. Still, rural bankers are experiencing challenges attracting compliance officers since talent is limited in the area.

Wyoming bankers reported some progress in the area of

management succession, but they said they are concerned about future prospects as younger employees tend to be more transient. One banker noted that his institution has been fortunate to have a good handle on succession planning; however, it remains a constant concern about how to replace employees during a time of unexpected loss.

