GERRISH'S MUSINGS

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Dear Subscriber:

Greetings from Florida, Minnesota, Wisconsin, West Virginia, Texas, Pennsylvania, Missouri, Iowa, Louisiana, Illinois, and California!

DEPOSITS, DEPOSITS, DEPOSITS

As we continue to move toward the height of strategic planning season, it appears that the concern on every community banker's mind is how to effectively gather deposits without breaking the bank. Of course, any community bank can raise their rates and pull in deposits. We have been searching for the "silver bullet" on increasing stable core deposits but unfortunately have not found one yet. We do understand the concept that the lenders need to be encouraged or incented to bring deposits when they bring loans. We also understand the concept that the retail side should be doing what they can to retain deposits and get new deposit customers. That is all basic blocking and tackling in banking. We also have a number of our clients who are using virtual branches to gain deposits through online resources. And of course, there's the Federal Home Loan Bank if you don't mind paying the freight. To say it is difficult to fund the growth of the loan portfolio without obtaining the funds to do so through deposits or borrowings is an understatement. We would be happy to share any ideas any *Musings* readers might have.

LOANS, LOANS, LOANS

For years, we have had an influx (surge) of deposits. This was particularly evident during the pandemic when the government was dishing out a lot of cash to a variety of families, individuals, and entities. During that time, when banks were flush with deposits and customers flush with cash, most of the focus was on loan demand. Based on our current visits with clients, loan demand is still very strong. We asked one community bank commercial lender why she felt loan demand was so strong since the interest rates are so high. She said because people are still making money, developing properties, building homes, and the like. Her comment was, "Life goes on." Anecdotally, we have seen strong loan demand in each of our community bank clients' markets. Surprisingly strong. In fact, as noted in the article above, the biggest issue is not the loan demand but how to fund it.

THE STRESSES OF LENDING

We recently had a discussion with a long-time bank executive that is nearing retirement. During the discussion, we hit on a number of topics, including the stresses of lending. This banker had two particular insights we found interesting. First, the individual recounted the stresses of lending. Basically, they said that lenders are really looking to satisfy the interests of shareholders, customers, and the regulators. Second, the individual believed those interests are not aligned, but are instead competing interests. Their point was basically that as one party becomes more satisfied, another party becomes less satisfied. Their overall comment was the difficulty and stress for a lender is finding the appropriate mix of satisfaction for each of these three interested parties. With the benefit of having thought about it for some time, we think this individual has made a very good and succinct point as to the difficulty of being a community bank lender.

CEO SUCCESSION

As we have often noted in *Musings*, one of the directors' jobs is to assure appropriate succession at the CEO level. We are seeing among our community banks across the nation that CEOs as a category appear to be an aging group. That means there is a lot of CEO succession issues that need to be addressed. Of course, some community banks, when CEO succession comes up, want someone exactly like the current CEO. Since cloning is banned for human beings, that's not quite possible. Some boards, when CEO succession comes up, simply decide to give up and obtain succession through a merger or acquisition transaction.

We are staunchly in favor of independent banks and believe CEO succession is simply something the board needs to tackle head on. It typically means asking the current CEO what his or her plans are for retirement and then begin working on how to fill that slot a couple of years beforehand. Are there internal candidates? Do we need to go externally? What kind of skillsets does the current CEO have that will leave when he or she leaves? CEO succession is a major issue and needs to be addressed early and appropriately by the board.

ATTRACTING AND RETAINING TALENT

During a recent strategic planning session we facilitated, one of the discussion topics (as usual) was attracting and retaining talent. Similar to many other discussions, this particular bank was discussing the difficulties in attracting and retaining talent. This bank is located in a smaller, rural geography, and the participants' comments were generally that it was very difficult to attract people from outside the town to come work for the bank in the town.

We talked about different strategies to attract and retain talent. During the discussion, the bank's HR Officer made what we thought was a very interesting comment. The individual basically said that during every job interview they ask the applicant whether they prefer an increased rate of pay or an increased level of autonomy. The HR Officer said that over the past 50 or so interviews, every applicant stated a preference for increased autonomy rather than increased pay. Basically, the comment was that applicants today value personal flexibility in schedule and how tasks are completed over a higher level of compensation.

We felt this was an interesting comment, but not surprising. We have heard a number of bankers give similar comments. If you are a community bank that is looking to attract and retain talent, keep in mind that pay and pay alone is likely not going to win the war. Instead, we think every bank needs to offer an appropriate combination of competitive pay, equity opportunities, and some level of personal autonomy to their employees.

YOU CAN'T BUY WHOLESALE TALENT

In one of our recent strategic planning sessions, we had a bank executive make what we thought was a very thought-provoking observation. During the planning session, we were talking about the current difficulties of the community banking environment. We expected this individual would point to the current deposit warfare and would indicate that liquidity is the top concern in the bank. This is the comment we have heard from many community bankers recently, and it makes sense particularly in light of the three significant bank failures we have seen so far this year.

Somewhat to our surprise, the individual did not list liquidity as their top concern. Instead, the stated top concern related to human talent. The individual's comment was that the difficulty in attracting, retaining, and developing talent was, in that person's eyes, the biggest risk facing the bank. As this individual put it, "You can go out and get wholesale funding at any time. You cannot go out and get wholesale employment teams." We thought this was an intriguing insight.

CORPORATE GOVERNANCE

Does your bank need a Risk Committee in addition to an Audit Committee? Depending on your community bank's business model, complexity, and size, the answer may be "absolutely." A number of our community bank clients as they get larger and more complex establish both a Risk Committee in addition to the already established Audit Committee. Of course, the Audit Committee deals with financial risk issues, while a Risk Committee deals with other risk issues. It is important to have coordination between the Audit Committee and the Risk Committee. This would generally be under the purview of the Chief Risk Officer. The goal, of course, is to identify, monitor, measure, and control risk.

ONE OF THE REGULATORS' NEWER HOT BUTTONS

It seems that one of the regulators' newer hot buttons is the relationship between the bank and its affiliates. Keep in mind, any entity that is deemed to be an "affiliate" of the bank, (i.e., which owns a substantial part of the bank or the bank owns a substantial part of it or does significant business with the bank), is a candidate for a friendly federal regulatory examination.

We have seen the regulators focus lately on issues between the bank and its holding company. Typically, what they are looking for are inappropriate payments of holding company expenses by the bank (a 23A violation), or some other relationship between the bank and the holding company that violates the rules regarding transactions with affiliates (basically Reg W). We have seen large shareholders get involved in this mix, including ESOPs and KSOPs with scrutiny from the federal regulators. This appears to be one of their new hot buttons. Please review your bank and holding company as well as other affiliated relationships before your next exam.

MANAGING TO THE REGULATIONS

One of our firm's general philosophies is that it is not appropriate to manage the bank to the regulations. In stating this, what we really mean is that the bank's decisions on certain items should be made in light of the regulations but should not be driven by regulation. In saying this, please do not hear what we are not saying. We certainly are not advocating any action which directly violates a regulation.

One of our bank clients has recently been considering the possibility of establishing a new bank branch. This branch makes great sense for the bank because it is in an area that is growing and is a logical extension of the bank's current geographic footprint. Unfortunately, the town where the bank wants to establish the branch is in an MSA. If the bank were to establish a branch there, it would bring the bank into HMDA reporting and similar compliance concerns. This has given the bank great pause in pulling the trigger on moving forward with the branch. Simply put, they are not certain whether the additional compliance burden that will be created by establishing the new branch is worth the additional business opportunities that would also be created.

We do not see this as an ideal situation. Unfortunately, this bank wants to do something that makes great strategic sense. However, if they do so, they are going to pick up a very significant additional regulatory burden. We wish the bank was not put in that position. Apparently, the government does not share the same view.

THE ENJOYABLE EXAMINATION EXPERIENCE

We have recently utilized a good portion of electronic ink in *Musings* to relay our view of the current regulatory environment. Those of you that have been reading *Musings* recently know that our view is not particularly rosy. We have recounted the difficult regulatory environment and have relayed several specific instances where we have seen the regulators getting much more aggressive. Apparently, this is not the current experience for all community bankers.

We were recently in a telephone discussion with a bank executive that had just finished up an examination. When we asked the banker how it went, the response somewhat surprised us. In the banker's words, it was an "enjoyable examination experience." Frankly, that was an unexpected response! The banker went on to tell us about how the examination had gone particularly well, the examination team was friendly and insightful, and in the banker's view was one of the best examinations they had ever been through.

One story makes not a trend. We think the examination environment is and will continue to be tough. However, there are at least some silver linings out there. For at least one banker, the last examination was a great one. We felt it only appropriate to pass this exam characterization along to provide fair and balanced commentary.

CONCLUSION

Weather is the topic of the day. Hot weather, bad weather, and hurricane weather. For those of you suffering from weather maladies, we suggest, "Hang in there. This too shall pass."

Stay safe. See you in two weeks.

Jeff Gerrish *Philip Smith* *Greyson Tuck*

Upcoming Webinars and In-Person Presentations

- September 7, 2023 - Independent Community Bankers of America Bank Director Forum (Virtual) "Practical Strategies to Reduce the Risk Associated With Being a Community Bank Director" (Greyson Tuck, Presenter) Registration: ICBA Bank Director Forum
- September 13, 2023 – Community Bankers of Michigan Bank Directors' College at Grand Traverse Resort and Spa (or Virtual) "They Don't Really Expect Me To Know That, Do They?" (Cliston V. "Doc" Bodine, III, Presenter) Registration: CBOM Bank Directors' College
- September 13-15, 2023 – Community Bankers Association of Oklahoma 2023 Annual Convention, Skirvin Hilton Hotel in Oklahoma City. "The Next Page for America's Community Banks" (September 14) (Philip Smith, Presenter) Registration: CBAO Annual Convention
- September 21-23, 2023 – Community Bankers Association of Illinois 49th Annual Convention & Expo, JW Marriott Indianapolis. "Strategic Planning: What To Do Different Now" (September 23) (Greyson Tuck, Presenter) Registration: CBAI Annual Convention
- October 11-13, 2023 – Independent Community Bankers of America Annual Bank Director Conference. "Ten Things Every Director Needs to Know Now!" (Philip Smith, Presenter); "Being a Director is Risky – How to Protect Yourself!" (Greyson Tuck, Presenter) Registration: ICBA Bank Director Conference
- October 29-31, 2023 – Western States Director Education Foundation Annual Symposium for Community Bank Directors, Westin Kierland Resort & Spa, Scottsdale, Arizona. (Jeff Gerrish, Moderator) Registration: Western States Annual Symposium