Wrap-Up on What We Learned: *Community Banking in the 21st Century*

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Community Bank Formation, Behavior and Performance

- There is a continued role for de novo banks. De novo entry can curb the exercise of market power and make banking markets more competitive. The weak economy has contributed to the bulk of the decline in de novo charters. However, there is some evidence that regulatory factors are also influencing the decline. We will know more as the economy continues to strengthen.
- Research suggests that net interest margins at community banks will rebound once monetary policy is normalized and the national economy improves. However, at least one banker questions whether history will hold and whether deposit costs might accelerate more quickly than the historical trend.
- Technology, especially adoption of mobile technology, is being driven by competition and the rate of smartphone adoption and will continue.

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The Effect of Government Policy on Bank Lending and Risk Taking

- The use of guidance as a macro-prudential tool (in this case, the commercial real estate guidance) had the desired effect of reducing commercial real estate concentrations. However, the same banks also reduced C&I lending, which is often partially collateralized by property, more than expected.
- The banks that participated in the Small Business Lending Fund increased small business lending significantly faster than other community banks. However, SBLF participants were increasing their small business lending faster than other banks before the SBLF was introduced. As such, the program does not appear to have increased the volume of small business loans beyond what would have otherwise occurred.
- Based on research and practical use, the appeals process is inconsistent across federal regulatory agencies, and could benefit from a clear standard and transparency.

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The Effect of Government Policy on Community Bank Viability

- Whether Dodd-Frank or other trickle-down effects, compliance costs are going up. Community banks are giving serious consideration to cuts in products or services – or in some cases, considering consolidation.
- The regulatory process has reacted to market failures driven by systemically important financial institutions, to the detriment of community banks.
- There are some positive changes to report, too!
- The deregistration cut-off in the JOBS Act appears to have led to a statistically significant reduction in pretax expenses and increase in net income.

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From Rebecca:

- Relationship banking needs and benefits from judgment – some of the regulatory changes in recent years are impacting community banks' ability to exercise judgment.
- Community banks take risk on entrepreneurs, which is vital to job creation. Regulation is making it more difficult to take risk on "non-traditional" borrowers.
- The goal should not only be consumer protection; rather, we need a balanced approach that allows community banks to flexibly respond to the needs of consumers.
- Tackle the obvious pressure points, including the call report, mortgage servicing rights capital limitations, and Sub S dividend restrictions.

The Community Bank Survey and Discussion Panel

- The data tells a story that we have already been hearing: two-thirds of survey respondents indicate they will not make non-qualified mortgages.
- The M&A trend will continue and may accelerate. Community bankers are TIRED (transition, interest rates, regulation, expenses, dependence on technology). Banker fatigue is a real phenomenon.
- The impact of technology adoption by consumers will have an impact on banks. Technology offers promise for community banks and is increasingly available. However, with technology comes new compliance challenges.
- Private equity will not be the answer to community bank capital. Investors in community banks will intentionally accept the rate of return produced.

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In closing…

- The threat of regulatory burden extends across community banks.
- Let's begin to examine opportunities for "proportionate" regulation, including opportunities to augment examiner discretion. Even small things can end up resulting in big things.
- And let's keep an eye on technology – whether to enhance competitive advantage or reduce the impact of regulation.

Next steps? We'll be in touch with you soon to see what you think!

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