Banking Law

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Community Bank Interests Are Not Addressed in Banking Media Coverage

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As fall arrives and football returns, banking headlines seem removed from the daily challenges and operations of community banks.

The industry's largest institutions await the Financial Stability Oversight Council's identification of "systemically significant" financial companies and some insight into how these companies would divest themselves of operations in times of market and liquidity stress. There is great anticipation as to whether the Federal Reserve's capital proposals required by Dodd-Frank will add further complexity to the already pending new capital requirements--the Basel III rules, the market, operational and counter-party risks and the counter-cyclical buffer. Also coming are proposed regulations for the Volcker rule restricting bank proprietary trading and bank investments in or sponsoring hedge funds and private equity funds. It is no surprise that major technology vendors are reported to be ramping up to offer the larger financial companies even more sophisticated financial risk analysis platforms with models to project loan defaults, liquidity crises or other stress-related events.

Meanwhile, community banks are less concerned with these headline-grabbing issues than with identifying income-producing opportunities in their communities in the face of continuing economic challenges. Community banks are already resigned to very high capital ratio requirements of 8% or 9% Tier 1 leverage and 12% and higher total risk-based capital ratios as many had these ratios inserted into enforcement orders by their regulators. Community banks are generally not in business lines or products which raise significant regulatory concerns or require special capital allocations. Community banks, however, have been sensitized by regulatory pressure to focus on credit quality and potential loan default risk, which they do based primarily on meetings with and fully understanding borrowers, not just analytical models. Most community banks have core deposit franchises and a Federal Home Loan Bank borrowing window to rely on for unexpected liquidity needs.

Community banks and their boards of directors have focused on enterprise risk and on adopting bank-wide risk and compliance management for some years now, and not risks that are not in the traditional community bank business model--subprime lending, securitization, credit default swaps, etc.—which combined to trigger the U.S. and worldwide economic shock waves which spread eventually to community bank business and retail customers. While too often community banks experienced high levels of loan losses and evaporating earnings, these were unfortunately followed by "rear-view

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mirror" CAMELS ratings slashes by examiners and enforcement actions with new high minimum capital ratios. Community bankers also have to deal with reputation risk, often because community banks have been unfairly lumped in with "those bankers" whose extravagant activities gave rise to Dodd-Frank and the current headline articles.

Thus, there is a disconnect between the attention being focused on restructuring the cornerstones of the U.S. banking system for major banks and investment banks instead of what is happening on the street corners in communities where the role of community banks is critical. Countless community banks are struggling to rebuild their earnings base, searching for loans they'd like to make to any local business that can show growth prospects and which can bring increased employment and deposit balances to the community supported by the bank. This cycle is locked in neutral at best for many community banks shackled with severe enforcement actions and with some justified fear of lending, given the rough examination climate they have endured. Meeting high capital ratios set by regulators has distracted many bank boards and management teams from the business of banking while they seek new capital sources. Unfortunately, this story does not have the pizzazz of stories of risk analytics modeling and enhanced stress testing, which may explain the dearth of articles on the plight of traditional community banking in the aftermath of Dodd-Frank.

When community bankers and their boards huddle these days, they are not so much focused on the banking media headlines, but on improving their blocking and tackling in their defined markets--loan quality and loan growth; strategic planning; director education and improved governance; strengthening internal controls and ensuring that information technology security protects customer privacy. Add to that miscellaneous Dodd-Frank provisions, such as paying interest on demand deposits, new parameters on preemption and, of course, lost debit card interchange fee revenue, and you have the major challenges for community bankers that do not make the headlines but nevertheless control the destiny of many community banks. Oddly, the feared Consumer Financial Protection Bureau, which in due course likely will establish tough new pro-consumer compliance best practices standards for smaller (under $10 billion in assets) banks that it will not directly regulate, may mean little more for community banks than increased compliance reporting. Generally community banks have done well in recent years on their compliance and Community Reinvestment Act examinations.

It would help if the national and local banking press paid more attention to the importance of community banks and the challenges they face. Hopefully the public would come to better understand that their local community banks generally were not a cause of the economic downturn but are of key importance to U.S. economic recovery and growth loan by loan and community by community.

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