2020 National Survey of Community Banks

Michael Stevens, Alisha Sears and Andrew Meyer

The views expressed are not necessarily those of the Federal Reserve System.
COVID-19 Issues
Last year, the greatest challenge facing banks was funding . . .

What is the single greatest challenge facing your bank today (in 2019)?

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulation</td>
<td>16.4</td>
</tr>
<tr>
<td>Competition</td>
<td>15.4</td>
</tr>
<tr>
<td>Cost of technology</td>
<td>6.8</td>
</tr>
<tr>
<td>Business conditions</td>
<td>6.6</td>
</tr>
<tr>
<td>Loan demand</td>
<td>11.8</td>
</tr>
<tr>
<td>Cost of funds</td>
<td>8.2</td>
</tr>
<tr>
<td>Core deposit growth</td>
<td>22.8</td>
</tr>
<tr>
<td>Attracting/keeping qualified employees</td>
<td>10.0</td>
</tr>
<tr>
<td>Other</td>
<td>2.2</td>
</tr>
</tbody>
</table>
... but this year, business conditions are by far the greatest concern.

Figure 4: What is the single greatest challenge facing your bank today (in 2020)?

- Regulation: 15.9
- Competition: 10.8
- Cost of technology: 5.6
- Business conditions: 34.4
- Loan demand: 7.5
- Cost of funds: 1.3
- Core deposit growth: 9.4
- Attracting/keeping qualified employees: 8.6
- Other: 6.5
Banks clearly stepped in to help small businesses that were hit by the pandemic . . .

Figure 6: Did you increase lending to small businesses and farms in response to the COVID-19 pandemic?

- Yes: 79.3%
- No: 20.7%
but the pandemic did not cause an increase other types of lending.

Figure 7: Did you increase non-businesses lending in response to the COVID-19 pandemic?
Even with all of the government guarantees, bankers closely monitor credit risk . . .

Figure 8: How important is credit risk to your bank?

- Very important: 56.5
- Important: 33.9
- Moderately important: 6.5
- Slightly important: 2.7
- Not important: 0.5
... but they are much less concerned about liquidity.

Figure 9: How important is liquidity risk to your bank?

- Very important: 15.9%
- Important: 29.3%
- Moderately important: 22.8%
- Slightly important: 21.0%
- Not important: 11.0%
Competition for deposits is just as important as ever . . .

Figure 10: How important is market competition as an impediment to attracting and retaining core deposits?
... but core deposit growth is less of a priority.

Figure 11: How often is core deposit growth currently prioritized over loan growth?
Most banks implemented work-from-home policies to protect employees and customers . . .

Figure 15: Did you implement a work-from-home policy for nonessential staff in response to the COVID-19 pandemic?

- Yes: 69.9%
- No: 30.1%
... but fortunately, there were very few lay-offs.

Figure 18: Did you reduce your full-time equivalent staff in response to the COVID-19 pandemic?

- Yes: 4.8%
- No: 95.2%
Bankers also sought to protect employees and customers by restricting lobby usage . . .

Figure 19: Did you restrict your lobby usage in response to the COVID-19 pandemic?

- Yes: 97.7%
- No: 2.3%
. . . but few banks closed branches, outright.

Figure 20: Did you close one or more branches (at least temporarily) in response to the COVID-19 pandemic?

- Yes: 23.0
- No: 77.0
Bankers pointed to...

- A renewed focus on the high-touch, relationship model
- Individualized/tailored relief for customers
- Feeling both proud and overwhelmed
- An appreciation of the “nimbleness” of community banks
Core Service Providers
There is a deep dissatisfaction with the cost of core service providers.

Figure 66: Regarding core processing services at your bank, whether in-house or through an external provider, how satisfied are you with cost?
and bankers aren’t happy with their flexibility.

Figure 67: Regarding core processing services at your bank, whether in-house or through an external provider, how satisfied are you with their flexibility?
However, there is remarkably little turnover in core service providers . . .

Figure 68: How long have you been with your core service provider?

- Less than 5 years: 13.7%
- 5-10 years: 15.0%
- More than 10 years: 71.3%
... in part because of the cost of switching providers.

Figure 69: How much would it cost to terminate your contract with your core service provider tomorrow?

- Less than 1 percent of my noninterest expense: 5.6%
- 1-3 percent of my total noninterest expense: 10.7%
- 3-5 percent of my total noninterest expense: 11.2%
- 5-10 percent of my total noninterest expense: 11.5%
- More than 10 percent of my total expense: 22.4%
- I do not know: 38.7%
Bankers are generally satisfied with their core service providers’ security . . .

Figure 73: Regarding core processing services at your bank, whether in-house or through an external provider, how satisfied are you with security?

- Highly satisfied: 16.4%
- Satisfied: 64.6%
- Neutral: 15.9%
- Dissatisfied: 2.1%
- Highly dissatisfied: 1.0%
... and with their risk management practices.

Figure 74: Regarding core processing services at your bank, whether in-house or through an external provider, how satisfied are you with risk management?
Banks are finding ways to innovate, but there are some hurdles.

Figure 78: Is your relationship with your core service provider an impediment to entering into a partnership with a fintech company?

- Yes, the contract includes an exclusivity agreement: 6.1%
- Yes, because my core service provider does not provide an open application programming...: 24.1%
- Both A and B: 11.5%
- No: 58.3%
Due diligence requirements are a barrier to new third-party relationships . . .

Figure 79: How strongly do you agree with this statement? Supervisory expectations for due diligence of a third-party provider are an impediment to establishing new third-party relationships.
... and bankers would like more information from regulators.

Figure 80: How strongly do you agree with this statement?
*Having more information about my core service provider from the banking agencies that supervise it would be helpful.*

- Strongly agree: 31.8%
- Agree: 45.9%
- Neutral: 17.0%
- Disagree: 3.4%
- Strongly disagree: 1.9%
The Bank Secrecy Act remains a major concern for bankers . . .

Figure 25: How important is Bank Secrecy Act (BSA) risk to your bank?

- Very important: 20.2%
- Important: 35.2%
- Moderately important: 30.6%
- Slightly important: 12.1%
- Not important: 1.9%
but most banks don’t experience follow-up from law enforcement.

Figure 26: Have you been contacted in the last two years by law enforcement related to a Suspicious Activity Report (SAR) or Currency Transaction Report (CTR) filed by your bank?
Reg burden is the greatest BSA concern . . .

Figure 27: What Bank Secrecy Act/Anti-Money Laundering (BSA/AML) issue concerns you the most?

- Compliance cost: 21.6
- Banking risky customers: 11.6
- Regulatory burden: 63.1
- Crypto currency: 0.8
- Alternative payment processors: 3.0
. . . but bankers are generally satisfied with their BSA technology.

Figure 60: How satisfied are you with the effectiveness of your bank's technology in the area of BSA compliance?
The BSA/AML “one-size-fits-all” approach

Bankers expressed burdens associated with:

- Time and resources spent
- Lack of transparency, information sharing, and timely feedback
- Collection of beneficial ownership
The Future Outlook
Bankers believe strongly in using new technology . . .

Figure 58: How important is the adoption of new or emerging technologies to meet customer demand in your market?

- Very important: 23.3%
- Important: 40.2%
- Moderately important: 24.6%
- Slightly important: 11.4%
- Not important: 0.5%
... but don’t necessarily want to be first adopters.

Figure 59: How important is it to be a leader in new or emerging technology adoption to meet customer demand in your market?

- Very important: 8.1%
- Important: 15.1%
- Moderately important: 31.7%
- Slightly important: 25.7%
- Not important: 19.5%
What will Community Banking Look Like in 10 years?

Hard to predict but...

- the role of technology will continue to expand
- geography and branching dynamics will change
- there will be an increased focus on the impact of pandemics, natural disasters, extreme weather events, and other climate-related changes
Quarterly indicator of how bankers, as local drivers of economies, feel about the future.

- Attitudinal Questions
- Business conditions
- Monetary policy
- Regulatory burden
- Expansion
- Profitability
- Franchise value

Register: index@csbs.org
Sector Outlook

- Health Care
- Professional Services
- Tourism
- Oil & Gas
- Manufacturing
- Restaurants
- Retail
- Construction
- Agriculture
- Consumer

Negative to Neutral: 3rd Quarter, 2nd Quarter, 1st Quarter