theBHCA.org — Summer 2021

Bank Owner

Bank Holding Company Association Magazine

The Community Bank Branch

Customer behavior drives evolving role

Spring Seminar Coverage:

- *Strong economy brightens outlook*
- *Tech's role in service delivery to grow*
- *Expected tax increases to impact banks*

Fed Notes: Banks and Fintechs

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The Bank Holding Company Association exists to provide education and business connections critical to the vitality of bank holding companies. Founded in 1981, the BHCA welcomes Members from around the country. Holding companies of all sizes from throughout the Midwest make up a majority of the current membership. Companies that serve bank owners, their holding companies and banks, are welcomed as Associate Members. The *Bank Owner* magazine is the quarterly publication of the BHCA. The magazine is your best source for BHCA information, including upcoming events. Members receive the magazine in the mail and have access to an online version at theBHCA.org. Managing Director Tom Bengtson serves as editor. Contact him at (952) 835-2248 or 1-800-813-4754 or email us at info@thebhca.org.

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Summer 2021

CONTENTS

Columns:

Feature:

Spring Seminar Coverage:

Departments:

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Strong response to virtual Spring Seminar sets stage for return to in-person event this fall

By Mary Jayne Crocker
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Our first-ever virtual Spring Seminar took place May 3-4 and I hope you were able to be a part of it. You may remember that last year, we cancelled our live meeting when the pandemic hit hard in the middle of March. This year, we planned an online version of the meeting that attracted more than 200 attendees, many favorable comments, and tremendous sponsor support.

"All the speakers and content were very timely," one attendee said on an evaluation form. "Thank you! I like the format and timing of the sessions. It worked well to have a break" in the middle of each day, commented another attendee. "My favorite moment was learning about the current economy, trends, technology and regulatory update," said still another attendee.

We work hard at the board and staff level to identify the right topics and speakers for our events. The realm of the virtual event is new for all of us, so this past year was particularly challenging in terms of scheduling, organizing and executing on a relevant event for our members. You will note that we shortened our schedule to accommodate the virtual format, and we changed our registration fee structure to encourage multiple people from the same organization to attend. Twenty-one member holding companies took advantage of our special group pricing and registered several people at a true value.

Another important factor is the technology partner. A meeting like our Spring Seminar is more than just a glorified Zoom meeting. With speakers calling in from three time zones, on-screen graphics, downloadable handouts, a variety of equipment scenarios, website accommodations, social media platform interfaces and post-event recordings to consider, there is a lot to coordinate. Our partner, metroConnections, did a great job.

And let me put in a good word for our sponsors. Twenty-two of our associate members stepped up to sponsor the Spring Seminar. They make a significant financial commitment, and we do not take that for granted. This support allows us to go the extra mile and put on a truly excellent event. This year, we did more marketing than in the past, buying a broader web presence including ads on LinkedIn. Not only does this promote the seminar, but it elevates the brand awareness of the Bank Holding Company Association.

We have received some excellent feedback from Spring Seminar attendees regarding topics for future seminar presentations. The technology, regulatory, human resource, and leadership arenas are all evolving so rapidly that sessions on all these topics are candidates for future seminars. If you have specific ideas you'd like to see addressed at future seminars, please let me or Tom Bengtson know.

As you read this, planning already is underway for our Fall Seminar, scheduled for Oct. 4-5, 2021. We are planning a live, in-person event at the Hyatt Regency hotel in Bloomington, Minn., near the airport and the Mall of America. Significant portions of the event also will be accessible via digital platform, so whether you want to attend the in-person meeting or take in the information from your desk, you will be able to participate. The event will focus on merger and acquisition topics. While the pandemic stifled M&A activity during the past 15 month, indications are activity is picking up; there will surely be a lot to talk about and I hope you will be part of the conversation at our Fall Seminar. Watch for marketing materials this summer.

It seems as though the pandemic is lifting in this part of the world. Many businesses, including Bridgewater Bank, have brought staff back to the office. While it was great to experience the advantages of remote work and witness the productivity, I look forward to enjoying the benefits of collaboration, spontaneous conversation, and in-person interaction that can only happen when we are all together in one place. See you all at the Fall Seminar! ■

A commencement address for bankers

It's June, which means you may have attended a graduation ceremony recently. These are hopeful events, where the conclusion of years of study is acknowledged and the start of a new beginning is celebrated. With fresh knowledge and new credentials, graduates go out into the world, hopeful of fulfilling their life's purpose and making the world a better place.

If I were giving a commencement address and the graduating class consisted of next-generation bankers, I would encourage the graduates to do four things:

Prioritize your customers — Never take a customer, or a potential customer, for granted. People have a lot of options for managing their money. Other banks, and other kinds of companies that offer bank-like services, all want your customers. Service is what will set you apart. Most competitors will not go the extra mile to win over a customer. If you are willing to meet customers on their schedule in a place that's convenient for them, remember birthdays and anniversaries, send handwritten thank you notes, and forward to them relevant articles and information, you will stand out from the crowd.

Do something extra for your bank — Assuming you have been at the bank long enough to master your job responsibilities, make an effort to understand how your work fits into the overall mission of the bank. Look for connections to other departments and jobs. Look for areas where improvements could be made. Speak up at staff meetings or all-company gatherings. Open a personal account at a competing financial institution and observe what they do; don't be afraid to share a good idea from that competitor with your boss and colleagues. Also, read, read and read some more… articles, white papers and books. Pass along the most compelling information.

Make a difference in your industry — Get involved with any of the many associations that serve the banking industry. Join a committee or volunteer for a project. Attend as many events as your schedule will allow. Go into each event with a networking plan, perhaps setting a goal to meet a certain number of new people. Make a point of developing contacts in other counties and states. Participate in any of the virtual forums run by the national organizations. And, make the most of your social media platforms. Share positive messages about things happening at your bank or in the industry or across the economy. As a banker, your voice has gravitas; use it to develop goodwill for the industry.

Give back to your community — Organizations need engaged volunteers at the grassroots level, at the board level, and at every level in between. Maybe your employer will let you volunteer on work time, but many of the most impactful bankers don't look at the clock when they are serving a club, school, hospital or other organization. They see what needs to be done, and they step up and do it — sometimes on a one-time basis and sometimes in a commitment that lasts for years. Don't worry about recognition or credit; just do what needs doing.

By Tom Bengtson
BHCA Managing Director

These four ingredients are a recipe for success. There are a lot of influencing factors in the banking industry that you simply cannot control, things like new laws and regulations, changing economic conditions, evolving demographics, and competitors eyeing your business. But these are four things you can control, four areas where you can make a difference. Make the most out of these opportunities, and it is likely to make the factors out of your control much less intimidating.

BHCA news

We have a new treasurer. Scott Bullinger of American Bancorp Ltd., in Dickinson, N.D., has stepped up to fill an opening created by Jeff Weldon, who recently left the banking industry and resigned his BHCA board seat. We appreciate Scott making the additional commitment to the BCHA, and we wish Jeff all the best.

The Bank Holding Company Association is governed by a board of 10 volunteer bankers. If you are an officer at your holding company, and would like to serve the association by joining our board of directors, please send me an email expressing your interest along with a resume. The board meets four times per year. In addition to providing general oversight to the operations of the organization, board members contribute ideas for programming, including our Spring and Fall seminars. Board members serve a three-year term and are eligible to serve two consecutive terms. Each fall, two or three board members are elected by the general membership at the BHCA annual meeting. Terms begin on Jan. 1 and run according to the calendar year.

The printed membership directory is on its way. You should receive your copy soon. Keep in mind that you also have access to an electronic membership directory at our website theBHCA.org. A directory of associate members is on the public portion of the site; a list of holding company members is available in the password-protected portion of the website.

Also, later this summer, you will receive our National Directory of Bank Holding Companies. This is the third edition of this unique resource. We present a list of holding companies from each of the 50 states and order them according to assets, largest to smallest. Plus, each listing shows the subsidiary banks for each holding company.

Down to Business, *Continued on page 13*

CUSTOMER BEHAVIOR *DRIVES* EVOLVING ROLE OF THE BANK BRANCH

COMMUNITY BANKS ARE RETOOLING THEIR BRANCH STRATEGIES TO ADOPT TO THE POST-COVID ERA

By Phil Davies

Last fall, while the Covid-19 pandemic raged across the country, Charter Bank of Eau Claire, Wis., bought a bank branch in Chetek, a resort community in northwestern Wisconsin. The $1.1 billion community bank saw opportunity in the area; during the pandemic visitors from Minneapolis and Chicago flocked to the small town and its surrounding lakes to recreate and buy property. Charter closed the deal with Bank First of Manitowoc, Wis., on Dec. 11, and three days later the branch opened as a Charter location, retaining its former Bank First deposits and employees.

With its Chetek purchase, Charter is betting that physical branches still have value after more than a year of severely restricted public access. Covid may have quickened customers' migration to online and mobile banking, but "we were convinced that there was still a need for some level of bricks and mortar — what we call presence," said Jeff Halloin, CEO of the bank's holding company, Charter Bankshares.

Bank owners are in the throes of rethinking their branch networks. This process has been ongoing for years, thanks largely to the rising popularity of digital banking, but the pandemic has brought the question of the future of branches into sharper focus. "What it has done is caused a serious reevaluation of what to do with a branch," said Jeffrey Gerrish of Gerrish Smith Tuck, a law firm and consultant to community banks based in Memphis, Tenn. "Do we keep it, sell it, reposition it?"

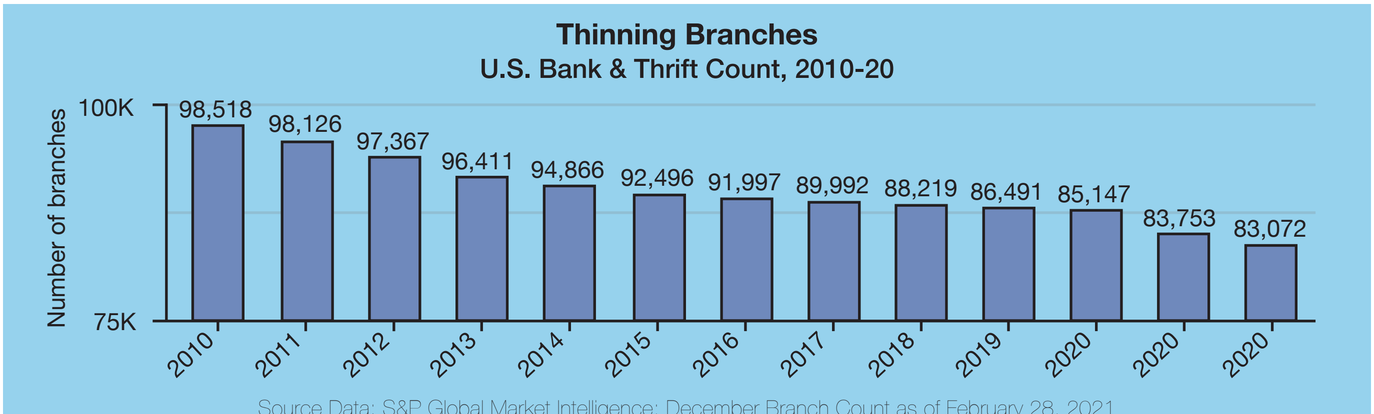
Aware that a substantial share of customers likely won't return to branches after Covid fears abate, community banks continue to invest in digital banking tools that kept them in business during the pandemic.

But small BHCs haven't abandoned the concept of the retail branch. While many large banks divest branches, most community banks are maintaining their branch networks — at least for now. Some are even expanding their presence in communities where they believe they have a competitive advantage. Community banks are also reassessing the services branches offer, staffing levels and the design of branches.

Hold 'em or fold 'em?

The death knell for branches has sounded often over the decades, initially when automated teller machines were introduced in the 1970s. Then came internet banking, followed by the smart phone, which empowered account holders to bank anywhere, anytime. With each innovation designed to eliminate the physical constraints of the branch (no waiting in teller lines!) branches survived; there has been no wholesale collapse of branch networks.

Instead, branches have gradually retrenched in the face of technological change. Over the past decade the number



of branches at banks and thrifts has fallen (see chart) as branch closings have outpaced openings. Branch attrition accelerated during the pandemic; the second half of 2020 saw a net loss of more than 2,000 branches nationwide, according to data compiled by the financial research firm S&P Global Market Intelligence.

The pandemic may have been a tipping point for big banks. Over the past year national and regional banks have sold or closed hundreds of branches, with no end to the culling in sight. PNC Bank is on track to close 120 branches this year, on top of the 160 locations it shuttered in 2020. Wells Fargo has announced plans to close 250 branches by year's end, and Truist Financial plans 800 closures by the first quarter of 2022.

Many large institutions have adopted a "thin branch" strategy, pruning locations outside core metro markets and relying on digital platforms to serve most customer needs. The way forward — whether to hold or fold branches — isn't as clear for BHCs; in large measure community banks derive their purpose from having a physical presence in communities, particularly those with few banking options, or poor Internet and cellular service that hampers online banking.

"They have this thing that you could call a conscience," Gerrish observed, "a moral compass that says, 'you know, we're the only bank in this town of 750 people. Can we really shut that branch down and keep our reputation as a community bank?'"

Jon Bruss, managing principal of Fortress Partners Capital Management, a strategic and capital planning advisor to community banks based in Hartland, Wis., notes that since the Great Recession community banks have "by and large not allowed their branch systems to get out of hand and have been trimming branches on a regular basis" to reduce costs. Many may be averse to further cuts.

Community bank leaders are taking different approaches to keeping branches relevant and profitable in the post-Covid era, informed by both the nature of the markets they serve and distinct visions of what it means to be a community bank.

Still committed to branches

Despite branch lockdowns, many community banks prospered during the pandemic. Demand for residential mortgages was strong, and applications to the federal government's Paycheck Protection Program poured in from beleaguered businesses. Banks that had developed digital services such as online deposit, bill pay and account opening before the pandemic experienced little disruption to their operations.

Many BHCs are leveraging their financial strength to pursue a two-pronged strategy: upping their virtual banking game while maintaining branch networks for customers they believe will return to branches when it feels safe to do so. Some banks have acquired locations from other financial institutions and even built *de novo* branches in key markets.

Charter Bank began investing heavily in digital platforms in 2015, hiring a chief information officer to oversee and upgrade an array of online and mobile banking tools. Halloin said they proved their worth in the pandemic, and the bank continues to make improvements and roll out new services. At the same time, the bank remains committed to its branch network, which includes two offices in suburban Minneapolis. During the pandemic customers frequently commented that they missed visiting their local branch, Halloin said. "Why this urge to come back? It was this need for connectivity beyond digital; they missed face-to-face contact with people."

That reaction to branch lockdowns was "an epiphany for us" that ratified Charter's commitment to branches, including its purchase of the Chetek branch, Halloin said. The bank is open to other opportunities to acquire branches — and whole banks — in its service area, although "we're going to be pretty selective," he said. "We want to make sure it's in our geography where we can serve those customers, and do so efficiently and profitably."

Horicon Bank, a $1.2 billion community bank with 19 locations in eastern Wisconsin, has also gone all-in on digital — in February it acquired a Georgia fintech firm to enhance its online and mobile platforms — while continuing to operate branches and develop new ones. "We still believe in branches as a sales function," said Senior Vice President Fred C. Schwertfeger. "That's where you engage with the community."

Sticking to an opportunistic growth strategy that has bought several new locations under the Horicon banner in recent years, the bank was planning to open two new branches in the Milwaukee metro area. Construction was underway this summer on a large new facility in the suburb of Wauwatosa, and a closed branch that Horicon acquired

Continued on page 8

Continued from page 7

last year was scheduled to reopen by September in the outlying community of New Berlin.

When less is more

Nationwide, branch sales activity has declined since 2015, although the number of deals rebounded slightly in 2020, according to S&P Global. But market observers anticipate a resurgence over the next year or two as large banks continue to winnow their branch networks and more community banks seize opportunities to expand into promising exurban and rural markets. "In the future, partially as a result of the pandemic, community banks will be big players in the purchase of branches that come up for sale," Gerrish said.

However, not all community banks are interested in enlarging their branch footprint. Consolidation is the overarching national trend for all banks, not just big banks, observes Marci Malzahn, a Minneapolis-based management adviser to community banks and credit unions. Community banks are cutting branches on a smaller scale than big banks, but they too are striving to reduce costs in an industry being reshaped by virtual banking.

"The fewer branches you have the more efficient you will be," she said. "The question is, what is the ideal number of branches that you need to have in order to accomplish your strategic objectives?" For a community bank whose customers have embraced digital banking, it may not make sense to keep a branch in a small town a few miles away from another location.

BHCs that have sold or closed branch facilities in the past couple of years include Bank First Corp., and the Heritage Bancshares Group of Willmar, Minn. In addition to selling its Chetek branch to Charter, Bank First closed a branch in the small community of Weyauwega, Wis., earlier this year, citing increased use of online and mobile banking services as a contributing factor.

In late 2019, Heritage Bank sold six small-town branches in northwest Iowa, a move in line with its adoption of a "digital first" strategy over the past few years. Customers can conduct most bank business, including applying for mortgages and business loans, on their computers and mobile phones, says Heritage Bancshares CEO Tom Geiger. The bank has held onto its main Willmar location and six branches in Minnesota, Iowa and South Dakota, but has no plans to add branches "because we're seeing a lot of growth in the digital arena," he said. The bank's mortgage business has doubled in each of the past two years on the strength of online lending to customers in six states.

Beyond the teller line

Besides reevaluating the reach of their branch networks, bank leaders are also pondering how branches can best serve customers and generate profits in an increasingly virtual environment. Even before Covid sent over-the-counter transactions into freefall, teller transactions at community banks had fallen by about one–third since the early 2000s. "The more pertinent question that bankers will be answering is, what do our branches look like going forward?" said Anton Moch, a banking and finance attorney at the Winthrop & Weinstine law firm in Minneapolis.

Many community banks are exploring new formats and technologies intended to boost efficiency and foster higher-value customer relationships. Jason Howard, CEO of First State Bank and Trust in Bayport, Minn., knew what he wanted in a new branch facility under construction across the St. Croix River in Hudson, Wis. Or rather, what he didn't want: "… somebody to walk in and the first thing they see is a big old teller line. We obviously have to conduct transactions like that, but they're not as common."

The branch's open layout — a hot trend in branch design — includes fewer, less obtrusive teller stations and four large conference rooms set up for video calling. A designated "concierge" will direct visitors to trust, commercial banking and other First State business units. "Eighty percent of the people who walk into our building won't be doing a teller transaction; they'll be there for something else," Howard said.

Following the lead of large banks, some community banks have installed interactive teller machines (ITMs) in their new or remodeled branches. Combining the convenience of the ATM with the personal touch of video calling, ITMs let customers talk face-to-face with an onscreen teller serving multiple branches from a central location. Horicon Bank was planning to set up ITMs in drive-throughs at its new Milwaukee-area locations and at several smaller branches as they're remodeled.

These innovations in the form and function of branches go hand in hand with a drive by community banks over the past decade to deploy a leaner, smarter retail workforce. Tellers are evolving into "universal bankers" trained to provide higher level services such as opening a deposit account or processing an auto loan. "Banks are reducing the staff of their branches, and giving them more responsibilities," Malzahn said, adding that the drastic drop in foot traffic during the pandemic has accelerated this transition to lighter-staffed branches.

As BHCs mull the future of the branch in the wake of the pandemic one thing is for sure: the ground will keep shifting under branches as digital increasingly becomes the way banking is done. But brick and mortar is likely to remain central to the identity of community banks, especially in small communities. The challenge for bank leaders is to strike the right balance between virtual and physical.

In this regard Bruss of Fortress sees a silver lining in the pandemic; working at home while bank offices were closed gave bankers a chance to "sit back and think about what they've done, and how they could perhaps do it better. I think the pandemic has been a boon to community banks." ■

Freelance economics and business writer Phil Davies is a former editor with the Federal Reserve Bank of Minneapolis.

Digital integration could give bankers an edge

Bankers are at a pivotal point in the banking industry, declared Steve Williams, president and founder of Cornerstone Advisors. The last 10 years, he said, were "about the disruption of customer expectations; the next 10 years is going to be about shareholder value being disrupted."

Williams was the opening speaker at the virtually-presented Spring Seminar of the Bank Holding Company Association on May 3.

Evolving customer expectations demand changes to the traditional community banking business model, he said. Adopting and effectively utilizing technology will characterize the transformation. While community will remain essential to successful banking, its definition will shift to an affinity rather than a geography, Williams said.

Williams urged bankers to invest in the transformation of their business model to better compete with fintechs for younger customers. He noted that the oldest millennials are now 40 years old. The changing demographics mean customer expectations have changed. Fintechs such as SoFi, Zillow, Rocket Mortgage and others offer "clear, crisp interfaces, chock full of data that has been analyzed and personalized," Williams commented. "They are about process automation, speed of delivery, and ease of doing business."

Competition from a dizzying array of fintechs complicates the challenge for community bankers who already are dealing with margin compression and excess liquidity which impedes loan growth. Williams encouraged bankers to start with a strategic plan that takes a hard look at the way the bank is currently operating and envisions something better in a decade. Part of the conversation should carefully consider the role of the bank's branches. Furthermore, bankers should consider ways to apply digital applications to marketing and sales, in addition to products and services.

Williams further suggested bankers consider:

» ***The major core processing companies are not going to be of much help.*** "They are not waiting over the hill to save us," Williams said. "The truth is, they have a shortage of skilled professionals. It is dangerous for us to think they have the resources to save us."

» ***Many banks need to have a serious discussion about their branches.*** Williams said the largest banks run about $250 million in deposits per branch. "Regional banks are at about half of that, and community banks are half that, again," Williams said. "Is that the highest and best use of capital?"

» ***Customer loyalty at community banks has improved during the pandemic.*** "Banks should be doubling down on that loyalty," Williams said. While the largest banks are focusing on cost-cutting, which in some cases have made them unpleasant work environments, community banks emerge as great places to work. Local banks need that talent and should go after it, Williams said.

» ***Niche is the new community.*** "Community is not St. Cloud, Minnesota," Williams explained. "Community might be veterinary SBA loans on a national basis, or how we provide cash management services to the medical community."

Digital Integration, *Continued on next page*

Economy strong, but broader factors also key

The economy is strong and will only get stronger as the country emerges from the pandemic, boding well for the remainder of 2021, explained Don Musso, president and founder of FinPro, Inc., in an address to the BHCA Spring Seminar on May 4.

Describing the exceptional position of financial strength from which the banking industry currently operates, Musso said the industry is highly capitalized and over-reserved. GDP growth is strong, (6.4 percent in the first quarter) achieving pre-pandemic output levels much sooner than experts expected a year ago. Consumers have a high level of savings and a pent-up desire to spend. A robust stock market is contributing to consumer confidence.

"We have a sterling economic recovery going on," Musso commented. "If the politicians don't screw it up, we are going to be in great shape through 2021."

While the Federal Reserve continues to downplay the possibility of inflation, Musso said the economy is heating up. He pointed to a steepening yield curve with the 10-year Treasury Bond nearing 2.0 percent. The spread between the 10-year and the two-year Treasury bonds is about 160 basis points, which Musso noted is considerably higher than the historical average of around 115 basis points. Spreads of 200 to 225 basis points that the economy experienced in the 1990s, Musso observed, lasted only briefly. "If the 10-year gets to 2.25 percent, we will see short rates start to climb," Musso said. "Whether Fed Chair Powell wants to increase rates or not, the Fed will not be able to contain the inflation juggernaut."

Musso pointed to rising commodity prices to make the case that inflation is a real concern. In the last year, he said, the price of lumber is up 262 percent, silver, aluminum and copper are up substantially, and corn is up 72 percent.

Bankers need to monitor key macro changes taking place in the economy. The need for commercial office space, for example, is going to decline as companies allow more employees to work from home, Musso said. This will reduce the value of a key category of collateral for many commercial banks. Musso said this trend will hit the industry in the 2022-23 time frame, as the remaining term of most commercial leases is currently masking the decline in demand for space.

With tax rates expected to climb, Musso said banks will feel an impact. "When Trump lowered taxes, bank stocks went up 21 percent," he commented. "Therefore, I think we can expect, if we see an increase in taxes on businesses that bank stock values will go down."

An increase in the capital gains tax rate, which is proposed to almost double, would have an effect on the markets far beyond the wealthy, Musso said. Combined with state taxes, the rate would reach into the mid-50s in some places, likely encouraging migration of the wealthy and upper-middle class out of traditional "blue" states.

"It is much more likely that taxes are going to go up," Musso summarized. "That is going to affect debt service coverage ratios for all of us and will impact the value of our banking franchise."

In addition, regulators are increasingly concerned about asset quality, which Musso said can be difficult to gauge in the current era of forbearance. Regulators are looking particularly hard at loan exceptions. "If you are doing a lot of policy exceptions in underwriting loans today, you will get a 'matter requiring attention' notice on that issue," Musso said.

Furthermore, the regulatory environment is changing with a renewed emphasis on UDAAP and disparate impact. Unfair, Deceptive or Abusive Acts or Practices will be targeted by regulators, Musso said, warning that the term "abusive" remains undefined in law. Disparate impact is another re-emerged regulatory hot-button, Musso warned, subjecting banks to often unpredictable regulator judgment. ■

Digital Integration, *Continued from page 9*

» ***Community banks will have to be more tech driven.*** Williams asked, "When you think about a successful fintech, what portion of that business is financial and what portion is technology?" He answered that in 2023, "surviving community banks will be 60 percent financial and 40 percent technology." Analytics, digital delivery and process automation will be the key tech roles, he said.

» ***Traditional marketing won't cut it.*** "We have got to be next generation marketers," he said. "A relationship in the new world is about engaging people in the channels they are using and making sure that as they are making payments through their Netflix account, that's your digital wallet" that's facilitating the payment.

"We have to become a digital first delivery mash up with great talent that has towering knowledge," Williams summarized.

A bank needs a crystal clear business plan that defines their place in the marketplace (Nordstrom, Walmart or Amazon) in order to attract the talent that it is going to require to succeed. Williams said skilled and talented employees want to work in a place "where they feel they can win."

"Winning cannot be a community bank running 18 lines of business across six markets, two of which have some growth," Williams said. "You've got to get it down to: 'Where do we want to play? How are we going to win?'

"In 2030, you are going to see this great tapestry of niche, modernized independent financial institutions, full of talent, great places to work, and it is going to be much more diverse when we think about independent banking nine years from now." ■

By Tom Bengtson

Expected tax law changes will impact banks

Bankers can expect their corporate, capital gains and personal tax rates to increase as Congress and the White House consider plans to fund new programs. Mel Schwarz and Jay Heflin, who direct legislative affairs programs for the accounting firm of Eide Bailly, provided a tax update at the BHCA Spring Seminar on May 3.

President Biden recently announced plans to provide $1.8 trillion over eight years on programs designed to help families, and $2.65 trillion over eight years on infrastructure projects. The plans involve the following provisions:

- Raise the top income tax rate to 39.6 percent from 37 percent;
- Raise the top tax rate on capital gains and dividends to 39.6 percent from 20 percent;
- Expand the 3.8 percent Net Investment Income Tax to apply to other types of income currently not subject to it;
- End the step-up in basis for gains of more than $1 million at death; and
- End the tax deferral of like-kind (1031) exchanges over $500,000.

Heflin said the White House is proposing the top personal tax rate start at $452,000 for individuals and $509,000 for couples.

Republicans are united against tax increases; Democrats are split, Heflin notes. With a six-seat edge in the House, and even representation in the Senate, many pundits expect Democrats to lose control of the House and the Senate in the 2022 election. "Many of them realize this may be their only shot at major tax legislation," Heflin said.

Some observers expect lawmakers to combine the two spending packages into one bill, while others say the plans are too ambitious. Heflin noted it is unlikely lawmakers will want to vote on two bills in one year that will increase taxes.

Schwarz said that even if Congress does pass legislation to increase taxes, rate increases may phase in over years rather than take effect all at once.

When President Trump led a change in the tax law in 2017, some banks changed to C corp status from S corp. Schwarz said given the expected near-term trend in taxation, it may be time again for bankers to consider whether a change in incorporation status makes sense. ■

Expert: Take a closer look at vendor contracts

As third-party relationships grow increasingly important at most banks, experts recommend bankers pay attention to contracts that define the parameters of those working arrangements. Caitlin Houlton Kuntz, an attorney with the Minneapolis-based law firm of Fredrikson & Byron, encouraged bankers to look closely at these contracts, particularly in cases involving customer data. Houlton Kuntz presented at the BHCA Spring Seminar on May 3.

"Vendor contracts have gotten more complicated. They require a heightened level of review and negotiation," Houlton Kuntz said. "Regulators expect board and management to review and understand what your third-party relationships are, and they have an expectation that you actively negotiate those contracts."

Houtlon Kuntz suggested bankers begin by taking a step back from the many details that go into a vendor relationship. "Take a look at the big picture," she counseled. Understand what the vendor is supposed to do, what information they need access to to do their work, and what the bank's obligations are. Banks should distinguish between customer data and bank data, because different sets of data require different rules for handling, she explained.

Sometimes vendors work with a broad range of clients so their contracts might not address the peculiarities of bank regulation. Bankers should ask for adjustments where necessary. Also, they should verify that contracts affirm the bank's ownership of its customer data.

Security breaches are significant events; sometimes hackers gain access to bank customer information through a vendor. Bankers should be aware of the kind of information security program in place at the vendor organization. Remedies, including the right to terminate the vendor relationship, should be described in the contract. A "right to cure" in the event of a breach could be meaningless; a bank should consider such clauses carefully. "These things are uncomfortable to talk about but are very important," Houlton Kuntz said.

The rules around information security are attracting a lot of regulator attention and are likely to become more exacting. "There are regulatory proposals in the works that would impact regulatory requirements on certain types of vendors," Houlton Kuntz said. "It's not a matter of if, but when." ■

Rate changes should not disrupt income stream, expert says

Regardless of the interest rate environment, a bank should be able to count on a steady stream of income, according to Scott Hildenbrand, managing director and head of Financial Strategies for Piper Sandler. Hildenbrand addressed bankers participating in the BHCA Spring Seminar.

"Changes in interest rates should not dramatically affect your income stream," he said. Effectively managing interest rate risk means understanding your bank's liquidity position and knowing what part of the yield curve matters most to you, he said.

Hildenbrand encouraged bankers to adjust their bond portfolios according to small shifts in rates, as little as 25 basis points. Hildenbrand also said banks should consider their cash position. "Sitting in cash is a major rate bet," he declared.

Most banks, Hildenbrand said, are highly exposed to the short end of the yield curve, meaning they have not benefited from rising rates at the long end of the curve. The majority of securities held by banks have maturities in the five–year range, he said.

> ***"Sitting in cash is a major rate bet."***
>
> – Scott Hildenbrand

Hildenbrand encouraged bankers to make strategic decisions about their bond portfolio. "Figure out why you don't benefit from shifts in interest rates," he said. "If rates go up on the 10–year and you didn't benefit, consider why you didn't."

Statistics show that the percentage of banks using derivatives has grown, currently to about 68 percent of all banks with assets ranging from $1 billion to $20 billion. Hildenbrand, however, argues the percentage is higher since many standard financial instruments are actually derivative investments. "The only difference is accounting," he said. ■

Modeling can help bankers weather liquidity challenges

A flood of deposits has drastically changed the balance sheet at most banks during the last year; bankers are looking for ways to put money to work, which is proving difficult at a time when loan demand is soft in many areas of the country.

Sean Statz, a senior manager at Baker Tilly, explained that in the last 12 months deposits have grown on average by 24 percent at banks in the Midwest, while loans have grown only 4 percent, including loans extended through the Paycheck Protection Program. The average loan to deposit ratio has dropped to 70 percent from 82 percent. It's the lowest loan to deposit ratio since 2013, Statz said. Cash and short-term investments increased on bank balance sheets to 11.25 percent from 7.19 percent.

The shift from higher-yielding loans to lower-yielding cash and short-term investments has put pressure on net interest margins, Statz noted. The median net interest margin as of Dec. 31, 2020, was 3.47 percent, the lowest in more than 20 years.

Statz encouraged bankers to make plans to deploy "surge" deposits, which he defined as money coming into the bank beyond the trend growth in deposits. He urged bankers to model several scenarios because it is impossible to know how long customers will leave this money in the bank. "You should make different assumptions about these funds than you should for traditional deposits," Statz said. "How long will these deposits stay in the bank? Three months? Six months? Two years?"

Detailed analysis can help bankers make plans. He encouraged bankers to segment their deposit data as granularly as possible. Segments worth analyzing, he said, include commercial versus consumer, and high net worth versus low balance.

Bankers can start to stress-test their liquidity position by plotting future contractual cash inflows and outflows generated from current loans, investments and maturity deposits. Bankers can study deposit behaviors from previous stressed economic times as a baseline, Statz suggested.

Bankers should also analyze credit risk. How will the bank be impacted by increased loan defaults and/or by decreased loan originations. Bankers should incorporate primary and secondary cash sources from the Federal Home Loan banks, mortgage collateral and elsewhere.

All of this analysis will help bankers answer the question: At what point do we hit a liquidity crisis? ■

Skilled coach helps teammates make most of customer relationships

Bank managers need to consistently coach their lenders, personal bankers and other team members responsible for generating new business if they expect their customer base to grow. Jack Kasel of Anthony Cole Training encouraged managers to do more to help their direct reports succeed. Kasel spoke at the BHCA Spring Seminar.

Among the most common weaknesses of sales coaches, Kasel said, are: they are inconsistent about coaching and debriefing, they don't ask enough questions, they do not have a sales process, they lack clear goals and a plan, and they don't know what motivates their relationship managers.

Successful coaches are available; they keep appointments with relationship managers because canceling them sends a signal that coaching sessions are not important. Kasel said good coaches avoid a temptation to micromanage, they offer praise frequently, and they have mastered the use of technology that is helpful to the sales process, such as a customer information system.

Only 2 percent of managers are good coaches, Kasel said. Many have never been coached themselves, or were poorly coached. Kasel encouraged managers to work on their coaching skills, and to start by getting to know their relationship managers better, and by defining and writing down clear goals.

"Selling is not at its core a business transaction," Kasel said. "It is first and foremost the forging of a human connection." ■

Bank provides examples of culture-building programs

A flood of deposits has drastically changed the balance sheet at most banks during the last year; bankers are looking for ways to put money to work, which is proving difficult at a time when loan demand is soft in many areas of the country.

Bell Bank has built a winning culture since its founding in 1966 by consistently promoting values that celebrate its customers and employees. Julie Peterson Klein, a 22-year Bell Bank employee, gave BHCA Spring Seminar attendees a peek at the Fargo, N.D.-based bank's culture. The bank consistently wins "Best Place to Work" honors, and recently surpassed the $10 billion in assets size mark.

Peterson Klein, executive vice president and the bank's chief culture officer, explained that the bank is committed to:

- Promoting and sustaining a family atmosphere
- Providing unequaled personal service to every customer, and
- Paying it forward by giving back to the communities the bank serves.

Peterson Klein said the bank's values help to create "happy employees and happy customers."

She described the bank's Pay It Forward program, which has resulted in $18 million in employee-directed giving over the last 13 years. The bank empowers each of the bank's 1,600 employees to donate $1,000 to the charity of their choice every year. Calling it a "signature program," Peterson Klein said the program gives employees a unique way to build relationships in the community. Employees are encouraged to communicate directly with the recipient of the gift. Sometimes, groups of employees team up to make larger donations to an individual charity.

Peterson Klein also described a "How Bell of You" program where employees are recognized for going above and beyond the normal expectations of good customer service. "At the end of the day, we want to make the world a better place," Peterson Klein explained. She challenged audience members to commit to performing a random act of kindness.

Peterson Klein concluded with this summary of her leadership approach:

- Leading from the heart, 24/7/365.
- People first! Workload second!
- You can win a lot of followers by having excellent follow-up.
- It's the little things that matter the most. ■

Down to Business, *Continued from page 5*

The number of holding companies is shrinking, but there are still more than 4,000 holding companies across the country.

Let me mention one other benefit of BHCA membership. In July, holding company members should watch their email for the semi-annual information dashboard provided by associate member Baker Tilly. This is specialized demographic information, organized by state. This information, which provides insight into an area's vibrancy, can be very useful as you make long range plans.

Let me close by thanking all of our members — holding company and associates — for your continued membership and support. We exist to serve you, and we consider it a great honor to partner with you at this unique time in the industry's history. Watch for information this summer on our Fall Seminar, Oct. 4-5 at the Hyatt Regency and on your computer. Best wishes for a great summer! ■

By Linda Anderson

How will the Fed's new control rule impact collaboration with fintechs?

On September 30, 2020, the revised regulations related to determinations of whether a company has the ability to exercise a controlling influence over another company for purposes of the Bank Holding Company Act or the Home Owner's Loan Act became effective. The Board of Governors of the Federal Reserve System believes that the final rule will increase the transparency and consistency of the FRS's control framework. As a result, this change should help to facilitate permissible investments in and by banking organizations by providing bank holding companies, savings and loan holding companies, depository institutions, investors, and the public with clarity of the "facts and circumstances" that the Federal Reserve considers critical when assessing control.

Financial technology, commonly referred to as "fintech," dates back to 1949 when the credit card was invented. The term fintech gained popularity when online banking became mainstream. Over the past few years, the number of fintech startups has nearly doubled, increasing from 5,686 in 2018 to 10,605 as of February 2021. The Covid-19 global pandemic had a significant impact on this increase as businesses, including banks, were forced to embrace financial technology as a means for survival. The consumer's manner of conducting business changed as shown by the increase in total transaction value of digital payments from $4.1 trillion in 2019 to $5.2 trillion in 2020.

With the increase of online business, Americans were well positioned to move to digital banking. In 2017, Federal Reserve Board Governor Lael Brainard discussed in her speech, "Where Do Consumers Fit in the Fintech Stack?" how advanced technology-enabled tools should help the average consumer manage their finances, particularly through the use of smartphones. A 2016 Federal Reserve survey of Consumer and Mobile Financial Services found that 87 percent of the U.S. adult population had a mobile phone — the vast majority of which were smartphones. The survey also showed that smartphones are being used for banking purposes: 62 percent of mobile customers use their phones for activities such as checking their account balances before making a large purchase.

According to Governor Brainard from a 2016 speech, consumers — particularly millennials — are accustomed to having a wide range of applications, options, and information readily available to them. In 2018, nearly 75 percent of millennials in the United States used digital banking, with an estimated usage increase to 77.6 percent by 2022. A survey from Jumio and Javelin Strategy & Research further showed in their findings that millennials use their mobile banking apps most often to schedule person-to-person money transfers, transfer funds between accounts, and check their transaction history. The same survey also found that millennials are most likely to seek convenience with mobile banking compared to Baby Boomers and Generation X. Based on recent trends, digital banking has reached across all age groups.

With the rise in fintech startups, banks have become concerned that the fintech industry may pose a threat to banking, especially as fintech companies explore ways to simplify banking products and processes for savings and lending. According to PricewaterhouseCoopers, 88 percent of incumbent financial institutions believe their business will be lost to standalone fintech companies in the next five years, primarily due to the speed of technological change. Factors that banks must seriously consider are their customer and the strategy for satisfying their needs, especially millennials. As the forerunners in the digital age, millennials are the generation with the greatest and increasing purchasing power.

The *BankDirector* 2019 Technology Survey findings showed the necessity for banks to streamline customers' experience and improve efficiency as key for bank technology strategies. For 78 percent of survey respondents, improving the customer experience was a top objective in driving their bank's strategy related to investment, development and implementation of technology. The survey further showed that technology strategic objectives remained key in driving where banks were investing in technology: In 2019, 68 percent invested in automation and 67 percent invested money to enhance the bank's digital channels.

According to the *BankDirector* 2020 Technology Survey, findings indicated an increased use of digital banking channels; almost all respondents stated the increase was related to the pandemic.

One way that banks have responded to the risk of fintech companies competing for portions of their business is to use and partner with fintech companies to meet customer needs. When structuring these partnerships, banks must be mindful of requirements in the BHC Act, including restrictions on bank holding company activities and application requirements for companies that control banks. The Federal Reserve's new control rule will help BHCs and fintech companies understand the regulatory implications of their investments, contractual rights, and business interactions. Consequently, we would encourage organizations to consult the rule early and often when considering new partnerships. ■

Linda Anderson is a Senior M&A Analyst with the Federal Reserve Bank of Minneapolis.

Holding Company Transaction Report

Here are selected recent bank holding company filings with the Federal Reserve Banks of Chicago, Minneapolis, Kansas City and St. Louis

▷ Royal Bancshares, Inc., St. Louis, Mo., authorized to acquire Saints Avenue Bancshares, Inc., New London, Mo., and thereby acquire Saints Avenue Bank, New London.

▷ Notice filed by Michael J. Bukstein, M.D., and others to acquire control of Farmers & Merchants Bancorp., Inc., and thereby control F&M Bank and Trust Company, both of Hannibal, Mo.

▷ The Yellowstone Bank, Laurel, Mont., filed to merge with 1st Bank, Broadus, Mont., and establish branches.

▷ Community First Bank, Boscobel, Wis., authorized to purchase the Lancaster branch of Wisconsin Bank & Trust, Madison.

▷ Colbank Bancorp, Columbus, Neb., has elected to become a financial holding company.

▷ First Eldorado Bancshares, Inc., Eldorado, Ill., has elected to become a financial holding company.

▷ Iowa State Bank, Hull, Iowa, filed to merge with Melvin Savings Bank, Melvin, Iowa, and thereby establish branches.

▷ OakStar Bancshares, Inc., Springfield, Mo., filed to acquire First Colorado National Bank, Paonia, Colo.

▷ North American Banking Company, Roseville, Minn., filed to establish a detached facility/branch in Maple Grove, Minn.

▷ High Point Financial Services, Inc., Forreston, Ill., filed to acquire Durand Bancorp, Inc., Durand, Ill., and thereby acquire Durand State Bank, Durand, Ill.

▷ American Bancor, Ltd., Dickinson, N.D., authorized to acquire The Citizens State Bank of Finley, N.D.

▷ Notice by Steven V. Chesney, Las Vegas, Nev., filed to acquire shares of First Lena Corporation, Lena, Ill., and thereby acquire shares of Citizens State Bank, Lena.

▷ The John C. Burgeson Residuary Trust and others filed to acquire shares of Iowa State Bank Holding Company, and thereby acquire shares of Iowa State Bank, both of Des Moines, Iowa.

▷ DDS Trust, Preston B. Steele as trustee, both of Huron, S.D., filed to acquire shares of 25 percent or more of Leackco Bank Holding Company, Inc., Huron, and thereby acquire American Bank & Trust, Wessington Springs, S.D.

▷ Foote Financial Services, LLC, Hoxie, Kan., filed to acquire Stanley Bank, Overland Park, Kan.

▷ NebraskaLand National Bank, North Platte, Neb., (to be known as NebraskaLand Bank) filed to retain its membership in the Federal Reserve System following its conversion from a national to a state charter.

New to BHCA

The Bank Holding Company Association welcomes a new holding company member:

Peoples Bankshares, Inc.
Michael Segner, President
Mora, Minnesota
Neighborhood National Bank

The Bank Holding Company Association also welcomes two new Associate Members:

Farmers National Company
Matt Gunderson,
Senior Vice President
of Sales & Marketing
Omaha, Nebraska

Farmers National Company has a 90 — plus year history of assisting non-operating landowners through banks and trust departments in the day-to-day operation of agency and trust assets providing peace of mind with a goal to increase income.

Our accredited managers, relationship executives, appraisers, real estate associates, foresters, insurance agents and hunting lease associates are here to serve where needed in order to achieve our client goals, a truly comprehensive team approach.

We work with bank and trust departments as their trusted advisor to their American landowner clients who have assets in the agriculture, forestry and energy industries. We understand a bank's fiduciary responsibility. Our processes are set up to meet Reg. 9 requirements, we are SOC-1 compliance working with bank and trust departments across the nation.

Primax
Glynn Frechette,
Senior Vice President
St. Petersburg, Florida

Mitch Prashak,
National Sales Executive
Des Moines, Iowa

Primax, a PSCU business, provides community banks with an expansive array of value-added services and customizable solutions to help profitably grow their portfolios and deliver an unparalleled experience to cardholders. With a longstanding commitment to service excellence, Primaz has been designing and providing support services for payment and card programs for financial institutions throughout theUnity States and the Caribbean for more than 40 years. See our website at www.primax.us

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