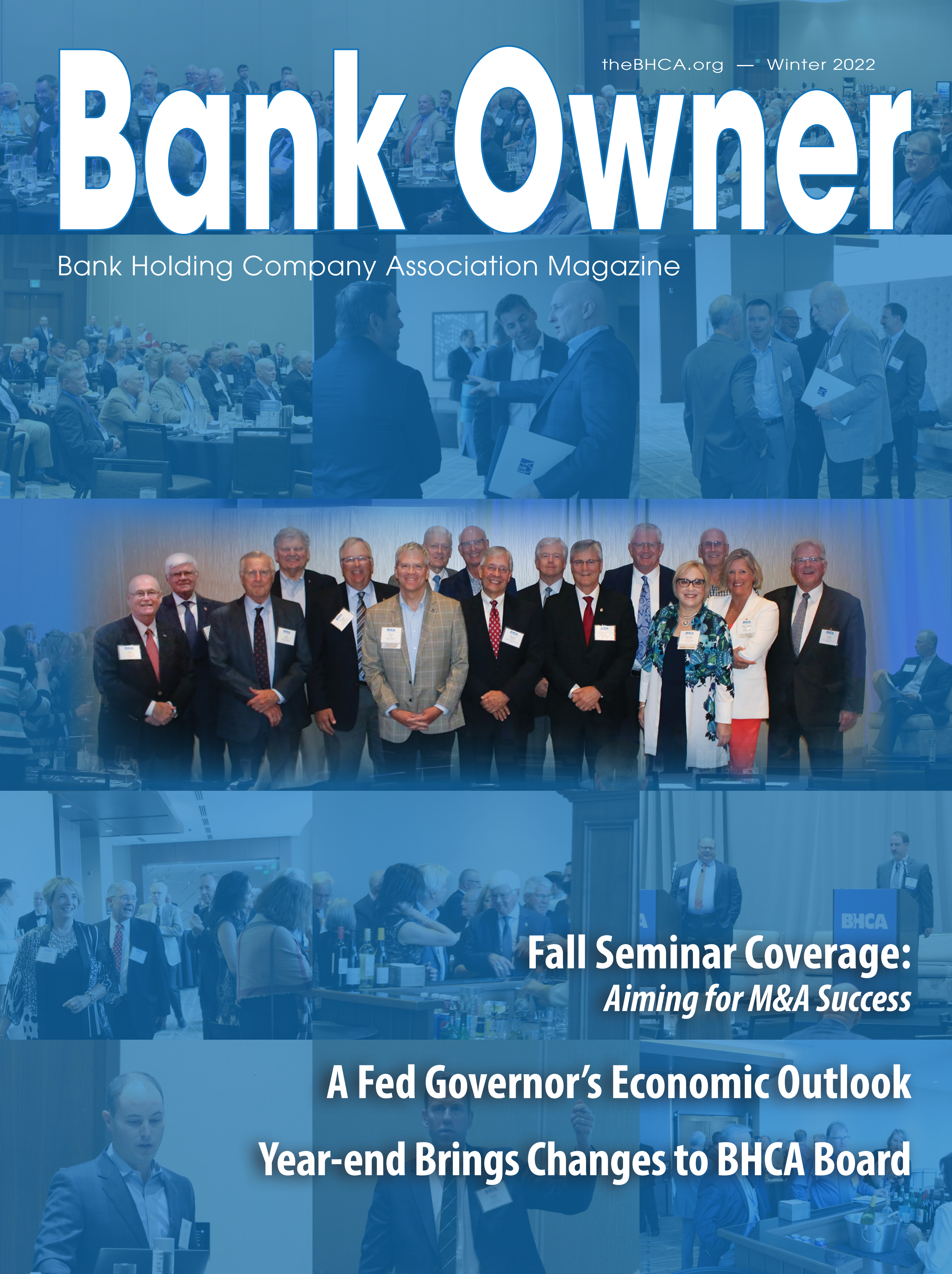
theBHCA.org — Winter 2022
Bank Owner
Bank Holding Company Association Magazine
BHCA
Fall Seminar Coverage:
Aiming for M&A Success
A Fed Governor's Economic Outlook
Year-end Brings Changes to BHCA Board

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Bank Owner

Winter 2022

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BHCA past presidents gather for a photo at the association's 40th anniversary. *See page 7*

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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 email us at info@thebhca.org.

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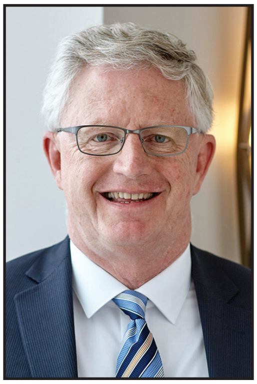
Fall Seminar exemplified the purpose, value behind the BHCA



By Tim Siegle
Ameri Financial Group, Inc.
Lino Lakes, Minn.

If you attended the Fall Seminar, I think you got a good example of what the BHCA is all about. The information delivered through the four general session presentations, two panels, and breakout sessions was excellent. We had a fabulous opening night celebration of our 40th anniversary, and the whole thing took place at the beautiful JW Marriott Hotel at the Mall of America. While there was plenty of time for learning, there was also social time for networking and reestablishing old acquaintances.

This was the fifth consecutive Fall Seminar planned around the theme of community bank merger and acquisition. The BHCA is perfectly positioned to host seminars around this sensitive but important topic. We are an organization serving bank owners, and what could be more pertinent to owners than a serious discussion about the value of what they own? We also have BHCA Associate Members who are some of the most knowledgeable people in the country working in the community bank M&A space. It makes sense for the BHCA to give them a platform to share their knowledge.

During the seminar, I had the pleasure of participating in a panel presentation with three other bankers who had recently been involved in various types of bank transactions. My bank was recently involved in the purchase of a bank that sold a portion of its assets to a credit union. It was noted more than once during the seminar that credit unions are becoming important buyers of banks. A lot of people don't like these deals because the result is a loss of income tax revenue to the state and federal governments. I have long believed that credit unions should pay income taxes just as banks do.

In Minnesota, there is a lawsuit pending which challenges a decision the Minnesota Department of Commerce made recently to prohibit a credit union from purchasing a bank. Ameri Financial Group is not involved in the suit, although the charter and branches we recently purchased came on the market because of the Commerce Department decision. The lawsuit notes that a few years ago, the Commerce Department allowed a similar transaction. It will be interesting to see how the court rules on this case. Furthermore, with the Governor's party now in control of both the Minnesota Senate and House, it will be interesting to see whether the legislature has any appetite to take this issue on and clarify whether credit unions can buy banks in Minnesota.

Getting back to the seminar, I want to make a special effort to thank the 16 past presidents who were in attendance to help us celebrate our 40th anniversary. Hearing stories from the early days of the association was so interesting. Times were different in the 1980s and 1990s, but the concept of an association for holding company officers and bank owners was on the mark. The BHCA has survived because it serves such an obvious and unique need.

Reflecting on the history of the association got me to thinking about my own career in banking, and I have to acknowledge the many people who helped me, or influenced me along the way. I have more than four decades in this industry and I have learned from so many people. And many of those people I met through BHCA events! The BHCA has been a great place to meet people, learn from others, and hear what's going on in a way that is meaningful on a practical basis.

I will be wrapping up my one-year term as president of the BHCA on Dec. 31. I have truly enjoyed serving the association and interacting with so many of the association membership.

President's Observations, *Continued on page 14*

2022 BHCA BOARD OF DIRECTORS

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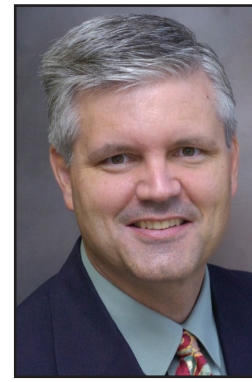
Payday lending story may provide insight into author-turned-Senator-Elect



By Tom Bengtson
BHCA Managing Director

Congressional elections come every other November, and this year they packed a weaker punch than many of the pundits had predicted. The party opposite the president always makes gains during midterms, but President Biden's party retained control of the Senate. Republicans gained control of the House, but it was a weak consolation prize given the relatively slim majority it won.

I am intrigued by J.D. Vance, the Trump-endorsed, author-turned-politician who won a U.S. Senate seat in Ohio. Shortly after Jelena McWilliams was named FDIC Chair in 2018, word spread that she was encouraging her staff to read Vance's "Hillbilly Elegy," the best-selling memoir. Fans say the book offers insight into people living in fly-over country and explains some of the political currents running through the midwest.

That may or may not be accurate but the book does include a curious story, which I think is worth passing on in this column. Vance writes about working at the Ohio Statehouse in Columbus while attending Ohio State University. He writes:

"The Ohio senate debated a measure that would significantly curb payday-lending practices. My senator opposed the bill (one of the few senators to do so), and though he never explained why, I like to think that maybe he and I had something in common. The senators and policy staff debating the bill had little appreciation for the role of payday lenders in the shadow economy that people like me occupied. To them, payday lenders were predatory sharks, charging high interest rates on loans and exorbitant fees for cashing checks. The sooner they were snuffed out, the better.

"To me, payday lenders could solve important financial problems. My credit was awful, thanks to a host of terrible financial decisions (some of which weren't my fault, many of which were), so credit cards weren't a possibility. If I wanted to take a girl out to dinner or needed a book for school and didn't have money in the bank, I didn't have many options. (I probably could have asked my aunt or uncle, but I desperately wanted to do things on my own.) One Friday morning, I dropped off my rent check, knowing that if I waited another day, the fifty-dollar late fee would kick in. I didn't have enough money to cover the check, but I'd get paid that day and would be able to deposit the money after work. However, after a long day at the senate, I forgot to grab my paycheck before I left. By the time I realized the mistake, I was already home, and the Statehouse staff had left for the weekend. On that day, a three-day payday loan, with a few dollars of interest, enabled me to avoid a significant overdraft fee. The legislators debating the merits of payday lending didn't mention situations like that. The lesson? Powerful people sometimes do things to help people like me without really understanding people like me."

I certainly did not expect to get a defense of payday lending when I picked up Hillbilly Elegy! But there it is, on page 185. I am thinking maybe this guy ends up on the Senate Banking Committee.

Thanks to board members

As 2022 comes to a close, three BHCA board members are about to conclude their service. I want to express my deepest gratitude to Brenda Johnson of Charter Bankshares, now Nicolet Bankshares (Eau Claire, Wis.) Mary Jayne Crocker of Bridgewater Bancshares (St. Louis Park, Minn.) and Michael Segner of Peoples Bankshares, (Mora, Minn.) for their service. On Dec. 31, each will include two consecutive three-year terms on the board, with Brenda and Mary Jayne serving an additional year as a result of serving as the association's president, Brenda in 2018 and Mary Jayne in 2021. All three bankers contributed meaningful ideas over the time of their service and I will truly miss working with them.

Please see the article in the magazine about the three bankers who will be joining us on the board of directors starting Jan. 1, 2023.

Thank you for your membership

At this point, all of our members should have received a notice regarding renewal of their membership for the 2023 calendar year. We sincerely appreciate your membership. I understand that you have many options for trade association membership, and that the competition for your time and attention is growing constantly. Thank you very much for your support of the Bank Holding Company Association.

The BHCA board of directors spends a lot of time considering the best topics for our seminar themes and presenters. We try to come up with both proven and new ways to deliver professional education that can't be obtained through other avenues. No sense repeating what everyone else is doing! If we can't come up with something a little different, then we shouldn't be here. Please watch for announcements in early 2023 about a new BHCA offering that will combine the best of education and networking. And, please continue to count on great seminars, with the Spring Seminar scheduled for May 1-2 and the Fall Seminar scheduled for Oct. 2-3. If

Down to Business, *Continued on page 15*

Reflecting declining stock prices, M&A market for community banks is tepid

If it seemed in 2021 like the community bank M&A market had rebounded from the pandemic slowdown of 2020, this year is proving the rebound to have been limited. Investment bankers addressing bank owners and senior officers at the Bank Holding Company Association Fall Seminar explained the pace of M&A activity is down, with the number of deals this year running about a third behind last year.

Craig Mueller of Oak Ridge Financial noted that by the end of September last year, 165 deals had been announced, whereas this year there have been only 112 deals announced.

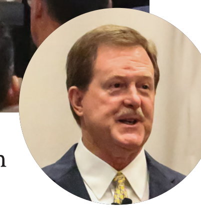
The Fall Seminar took place at the J.W. Marriott Hotel in Bloomington, Minn., with about 165 bankers attending the Oct. 3 all-day session, which included four general sessions, a round of four breakout sessions, and two panels featuring bankers sharing their stories.

Kirk Hovde of the Hovde Group noted that buyers in the current market tend to be banks with $1 billion to $50 billion in assets, and their most desired targets are banks with assets of $200 million to $500 million. Mueller commented that buyers currently outnumber sellers.

Prices are down from peak, given a general 25 percent reduction in bank stock prices. Stock prices reflect earnings, which are likely to continue to struggle following the diminishment of mortgage activity and PPP business that boosted earnings previously. Reduced stock prices, however, make offers from all-cash buyers more attractive, Hovde said. The rate environment is having a big impact on the market. Unrealized losses in securities portfolios have halted many deals and affected bank stock valuations for buyers and sellers, Mueller added.

Bankers have incentive to grow, Hovde said, noting that larger organizations have greater opportunities for efficiency. The median efficiency ratio for a bank with less than $250 million in assets is 70.2 percent compared with 56.7 percent for institutions with $5 billion to $10 billion in assets. Mapping the location of banks by size, Hovde predicted that most central U.S. buyers in the next few years are likely to come from Wisconsin, Illinois, Iowa, Missouri and Texas.

Curtis Carpenter of the Hovde Group spotlighted a growing trend of fintech investor groups purchasing small banks. He called it a "game-changer" for the financial industry. Carpenter said fintechs are buying banks to secure FDIC insurance. Though such deals have involved smaller banks so far, Carpenter said those mergers could prove consequential over the long-run as fintechs gain a foothold in the industry.


Curtis Carpenter

Hovde compared the amount of capital in the tech sector to banking. Though bank capitalization has reached a record high, the industry's $1.8 trillion market cap is still less than the $2.42 trillion held by the tech giant Apple alone, Hovde said.


Kirk Hovde

Also, bank tangible book values have fallen over the past several years: Fifty-four percent are currently trading under 1.5 times tangible book value, with only 50 above two times tangible book value. Four years ago, 150 banks were trading at above two times tangible book value.

The emergence of the fintech industry has drawn the attention of the Federal Reserve and industry professionals. The Department of Justice and bank regulators are evaluating their merger and acquisition policies for the first time since 1995. Last year, President Joe Biden issued an executive order calling on the attorney general and heads of federal banking regulatory agencies to update merger guidelines and oversight under the Bank Merger Act and Bank Holding Company Act.

The booming fintech industry comes as the number of banks contracts at a 5 percent annual rate, Carpenter noted. Though the pace of consolidations has eased, Carpenter expects M&A activity to eventually ramp up.

Both Hovde and Mueller noted the importance of credit unions in the bank acquisition marketplace. Hovde cited statistics showing in 2021 credit unions purchased $5.962 billion in bank assets through 12 deals, and so far this year, credit unions have purchased $4.217 billion in bank assets through 10 deals.

Hovde said more bankers are focusing on finding quality partners rather than on finding the highest bidder, but that for banks in growth markets with loan demand, the auction process is back in vogue. Even with the current slower pace, the rate of consolidation is reducing the number of opportunities for both buyers and sellers, Hovde said.

Despite the inroads fintechs and credit unions have made, community banks have been lauded for efficiently distributing Paycheck Protection Program dollars to small businesses. Carpenter said despite the challenging circumstances, community bankers still play a crucial role in the economy and have survived past crises. "You guys are a well-kept secret," he added. ■

BHCA PAST PRESIDENTS HONORED

Sixteen BHCA Past Presidents attended the 40th anniversary celebration that opened the Fall Seminar on Sunday, Oct. 2, 2022 at the JW Marriott Hotel in Bloomington, Minn. Gathered for this photo, they are, from left: 2014 - Bill Rosacker, United Bankers' Bancorporation, Inc., Bloomington, Minn.; 1981 - Robert Barsness, NORLO, Inc., Prior Lake, Minn.; 2006 - L. Lee Madetzke, North State Bancshares, Inc., Shakopee, Minn.; 2020 - Harry Wahlquist, MidWest Bancorporation, Inc., Eden Prairie, Minn.; 2004 - Bradley Bakken, Bakken Securities, Inc., St. Louis Park, Minn.; 2019 - Rick Wall, Highland Bancshares, Inc., Minnetonka, Minn.; 2013 - Douglas L. Farmer, Golden Oak Bancshares, Inc., Holmen, Wis.; 1992 & 1999 - Steven Kirchner, Richfield State Agency, Richfield, Minn.; 2012 - Bruce Ferden, Frandsen Financial Corp., Arden Hills, Minn.; 1996 - Paul Welle, First Bemidji Holding Company, Bemidji, Minn.; 2016 - Paul Means, Great River Holding Co., Baxter, Minn.; 2022 - Tim Siegle, Ameri Financial Group, Inc., Lino Lakes, Minn.; 2018 - Brenda Johnson, Charter Bankshares, Inc., Eau Claire, Wis.; 1988 - Thomas Johnson, American Bancorporation Holding Company, Brainerd, Minn.; 2021 - Mary Jayne Crocker, Bridgewater Bancshares, Inc., St. Louis Park, Minn.; and 2015 - Erick Gandrud, Eagle Investment Co., Inc., Glenwood, Minn.

Dealmakers' panel describes keys to M&A success

Four bankers described their recent M&A experiences during a panel presentation on Oct. 3 during the Bank Holding Company Association's Fall Seminar in Bloomington, Minn.

The dealmakers' panel was made up of Brenda Johnson, former chair of the Eau Claire, Wis.-based Charter Bancshares, which was acquired in August by Green Bay, Wis.-based Nicolet Bankshares; Tim Siegle, CEO of Stillwater, Minn.-based Ameri Financial, holding company of First Resource Bank; David Saber of Minneapolis-based Park Financial Group; and Jim Tubbs, president and CEO of Wisconsin-based State Bank of Cross Plains.

Johnson said the groundwork for the Charter Bancshares sale earlier this year began a couple years ago when the company committed to a more extensive strategic planning process as a way to become more data-driven. Charter introduced outside expertise and considered the necessary steps to stay independent, whether that would come through organic growth or by acquiring another bank. Eventually, leaders expanded their analysis to consider a sale, should the purchase options prove unrealistic.

While Charter's leaders explored acquisition opportunities, none panned out. Nor did thoughts about taking the bank public. Charter Bancshares eventually considered finding a partner to merge with. While initially the bank considered nearly every potential offer, it eventually narrowed the effort solely to partners that offered a true cultural fit. Johnson said Charter Bancshares eventually learned that Nicolet National Bank proved to be an attractive partner to merge with as a much larger community bank with similar values.

Tubbs explained the merger of equals deal that brought his bank together with Monona Bank, run by Paul Hoffmann. The merger of the holding companies took place the same day Tubbs addressed the BHCA, with the subsidiary banks planned to merge in February, in alignment with a core processing contract. The deal creates a $2.8 billion organization serving the Madison, Wis., market and surrounding area.

Tubbs said the four other acquisitions State Bank of Cross Plains has been involved in involved much smaller institutions. This deal, he said, brought together two shareholder groups, each of about 700 people.

"The stumbling blocks on a deal like this are the social issues," Tubbs explained. "Who's going to be the CEO? Who's going to be the board chair? What's the name of the bank going to be? Where will the headquarters be? What will the culture be? I knew the culture well. I knew what kind of a person Paul Hoffmann was, and how he values his employees and customers. I feel like we have the exact same things at the State Bank of Cross Plains."


Brenda Johnson


Tim Siegle


Jim Tubbs


David Saber

Tubbs said they agreed on most of the social issues at their second meeting. They quickly decided on a CEO, a chairman, a headquarters, and they agreed to come up with a new name.

The name of the post-merger bank is Lake Ridge Bank. The name pays respect to Monona Bank with the word "Lake" serving as a reference to Lake Monona in Madison. Cross Plains gets a nod from the word "ridge" as it reflects the bluffs in the area around Cross Plains.

Tubbs said they both required board members and other involved parties to sign non-disclosure agreements. Stressing the importance of confidentiality, Tubbs told his board members: "If you talk about this deal before we're ready, this deal does not happen." Rumors can be very destructive, he said, especially to employees who may act on them even before they have all the facts. But the NDAs seemed to have done the job. Even though the deal had been in the works for 11 months, Tubbs said, "No one saw it coming."

In past acquisitions, Siegle said First Resource has evaluated the location of the bank they are considering acquiring, and whether the balance sheet and culture are good fits.

Siegle noted that approximately half the time in board meetings at Ameri Financial is used to focus on strategic planning.

For banks negotiating an M&A, Siegle cautioned against negotiating every point of deal and being too focused on "winning" the deal, approaches he said can backfire due to the close relationships many bankers have forged with each other.

Saber, who has navigated four acquisitions building a $1.1 billion organization, said board meeting time is best when used to consider the toughest questions. "The tougher conversations we can have, the more progress we are going to make," Saber said. "At our last board meeting the board members asked me 'are you spending your time on the highest and best use for this organization?' A question like that resonates with me."

Saber said a good way to facilitate a translation is to authorize someone to take the next step. "You can expedite this process a lot by giving one or two people the authority to keep the transaction moving along," he said. ■

It's a sellers market, expert says


Scott Coleman

Sellers continue to have the upper hand in bank merger and acquisition agreements, according to Ballard Spahr Partner Scott Coleman.

Coleman said sellers are more aggressively setting their parameters for negotiation in their letters of intent. Buyers are more willing to accept qualifiers. "It's still a seller's market," he added.

Coleman said fintechs continue expressing interest in community banks, but advised sellers to be skeptical of the business plans of crypto and blockchain companies. Coleman advised bankers not to sign purchase agreements with a non-bank buyer unless they are willing and able to engage in a protracted M&A process – deals with non-bank buyers simply take longer, particularly if the buyer's bank deal experience is limited.

Coleman said credit unions are driving prices up in other markets and are active acquirers. Although he said bankers should feel comfortable accepting a good offer from a credit union, he strongly advised them to opt for a community bank buyer if the offer numbers are comparable.

However, he noted that credit unions are not currently viable as bank purchasers in Minnesota. Several credit unions and a trade association sued the Minnesota Department of Commerce this fall after the agency blocked a deal between Royal Credit Union and Lake Area Bank after finding that CUs are not allowed to buy state-chartered banks.

Coleman said there are numerous considerations banks must make when deciding whether to sell, including finding out if key officers are subject to restrictive covenants; whether they have the right team of advisers; whether they can explain key contracts to the buyer; and if their interest rate risk is managed and quantified. Banks must also consider whether there is sufficient capital in the business plan and consider that the capital must support operations for the first three years after the change in control takes place.

Immediately after a deal is announced, loan officers are sometimes offered significant signing bonuses to work for other banks. He also called on banks to clean up their balance sheets. Coleman also supports banks using non-disclosure agreements and evaluating their shareholder bases to decipher the quality of a fairness opinion.

Coleman said any transaction could be approved if the buyer establishes a good business plan and has sufficient capital levels to support that plan. Experienced management and consistent communication also helps move the process along. However, threats can arise when management objectives don't align with the buyer or seller. ■

Attorney: Banks must be proactive, patient during deals


Karen Grandstand

Banks facing M&A delays should be patient and proactively address any potential challenges with regulators, said Karen Grandstrand, chair of the Bank & Finance group at Fredrickson & Byron, on Oct. 3 during the Bank Holding Company Association's Fall Seminar.

To prevent delays, Grandstrand said banks should begin the M&A process with no existing regulatory challenges, even if they likely wouldn't prevent a deal from going through. Banks must also analyze their vendor contracts to determine the timing of the deal and any related cost issues; address potential employee risks by possibly offering a package that includes non-competes, and/or non-solicitation clauses.

Grandstrand said banks should also understand that in some cases it is less expensive for the buyer to pay the seller for increased tax costs associated with a deal.

Grandstrand's discussion comes as regulators under the Biden administration have taken a more aggressive approach to overseeing M&A deals than the previous administration.

Despite increased scrutiny, Grandstrand said banks in smaller communities will still need to grow to offer the services customers demand. ■

Targeted approach needed for banks upgrading tech offerings

Banks transforming their technology offerings must tailor their approach to accommodate their customers' needs and market niche, said RSM Senior Associate Elia Blankenship Oct. 3 during a breakout session at the Bank Holding Company Association's Fall Seminar.

Blankenship said banks should include peer analysis and client behavior data to help inform their future digital strategy. Banks looking to build their digital roadmaps should also consider who their vendors will be and understand that any contract will likely need to last at least five years. Other key steps include ensuring that their tech plan is aligned with their broader approach to business operations and customer engagement. For some banks, that could include a smaller tech footprint.

Many banks have not sufficiently integrated their existing technology offerings, Blankenship noted as she stressed the importance of banks aligning their back- and front-end offerings. Though the cost of introducing new technology to banks was once the No. 1 hurdle, Blankenship said a bigger challenge now is having the in-house resources needed for the transition. She cited a recent poll in which only 21 percent of banks said they have the skills necessary to successfully digitalize.

Still, Blankenship said, banks should have automation solutions, access to advanced analytics, machine-learning and other offerings as digital leaders outperform digital followers in labor productivity returns on investments. She cited one company's digital investment which resulted in a 10-percent reduction in cycle time in buying across channels. Automation played a key role in reducing payment processing times from two months to a week.

Blankenship's comments came as many banks look to increase their digital spending over the next few years as they face pressure from both larger banks and fintechs. A white paper released last year by Velocity Solutions said banks must develop digital loan platforms as fintech startups increasingly become industry competitors. At the time, the report found that community banks that are not offering small business lending say there is a lack of staffing to implement the changes; believe that doing so is not profitable; are confused over changing regulatory guidance, and lack internal IT resources to build such a platform. ■

Organizers of *de novo* EntreBank describe path to success


Dan Boeckermann

Speaking at the BHCA Fall Seminar, the organizers of Bloomington, Minn.-based EntreBank described their *de novo* bank's path to launch and their motivations for starting the first bank in the FDIC's seven-state Midwest region in 14 years.

The panel discussion was made up of Daniel Boeckermann, Tim Viere, Todd Hovland and Melissa Johnston. Viere now serves as CEO, Hovland as president, and Johnson as chief credit officer and marketing officer.

Boeckermann, who spearheaded the bank's launch, said he was looking to serve local small business owners and entrepreneurs. He had already co-founded Bloomington-based Venture Bank in 2001 and wasn't ready to be done with banking when Venture sold to Fargo-based Choice Financial in 2018.

In starting the *de novo*, Boeckermann had always enjoyed developing teams and wanted the C-suite to be driven and ambitious with an entrepreneurial spirit. He found perfect matches in recruiting Viere, Hovland and Johnston, who then brought on Chief Financial Officer Erik Knutson.

All four were already seasoned bankers: chief credit officer/marketing officer Johnston had spent the previous decade at St. Michael, Minn.-based Highland Bank, and the nine years before that at the $2.7 billion Minnwest Bank. Knutson joined the bank from Drake Bank in St. Paul. He had also worked at Boundary Waters Bank, American Bank and Equity Bank. Viere had been president at First National Bank of Northfield, Minn., before the bank was acquired by Merchants Bank, Winona, Minn., in 2019. Hovland had been a market president at MidWest*One* Bank, Iowa City, for the previous 11 years.

Though Johnston endured many sleepless nights considering whether she wanted to leave her comfortable job behind at Highland Bank, she said she trusted Boeckermann and relished the chance to work with new systems

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and processes.

The organizers described the logistical hurdles they overcame to open the bank. Though Boeckermann initially wanted a national charter, he learned that receiving one would delay the opening process by at least six months, so he opted to stay with the state charter.

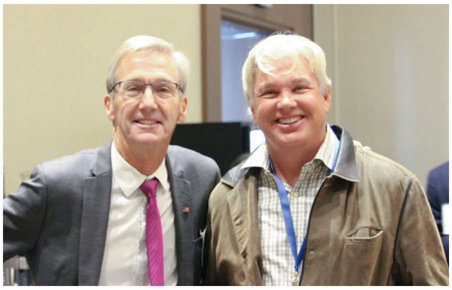
EntreBank officially opened in March with 14 employees in a space near the Mall of America. The opening was delayed a few months as organizers finalized a location. They sought a first-floor space centrally located in the Twin Cities suburbs. The bank was formed as an S-corp.

Viere said the regulatory process was "very positive" for EntreBank both as a team and a group. He stressed the importance of enacting policies and procedures before the bank launches.

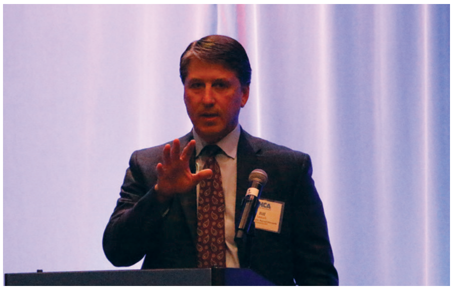
Though organizers initially hoped to raise $30 million, they eventually increased that goal to $40 million as positive feedback poured in. Of the $44.8 million the founding team eventually raised, the founding team committed $16.8 million of their own money. EntreBank was capitalized with $32 million, with reserves kept at the holding company to move into the bank as needed. It took just one month for the offering to be fully subscribed, Boeckemann said

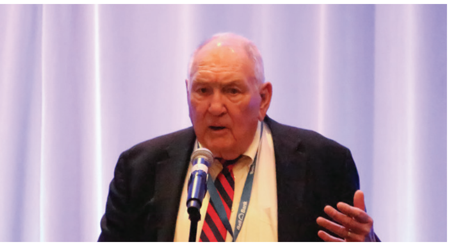
Hovland said the bank has grown in the first six months, a sign that there is demand for what EntreBank offers. EntreBank ended the second quarter of 2022 with $60 million in deposits and $51 million in loans. The bankers are hewing closely to their three-year plan with the goal of achieving $300 million in assets by spring 2025. ■

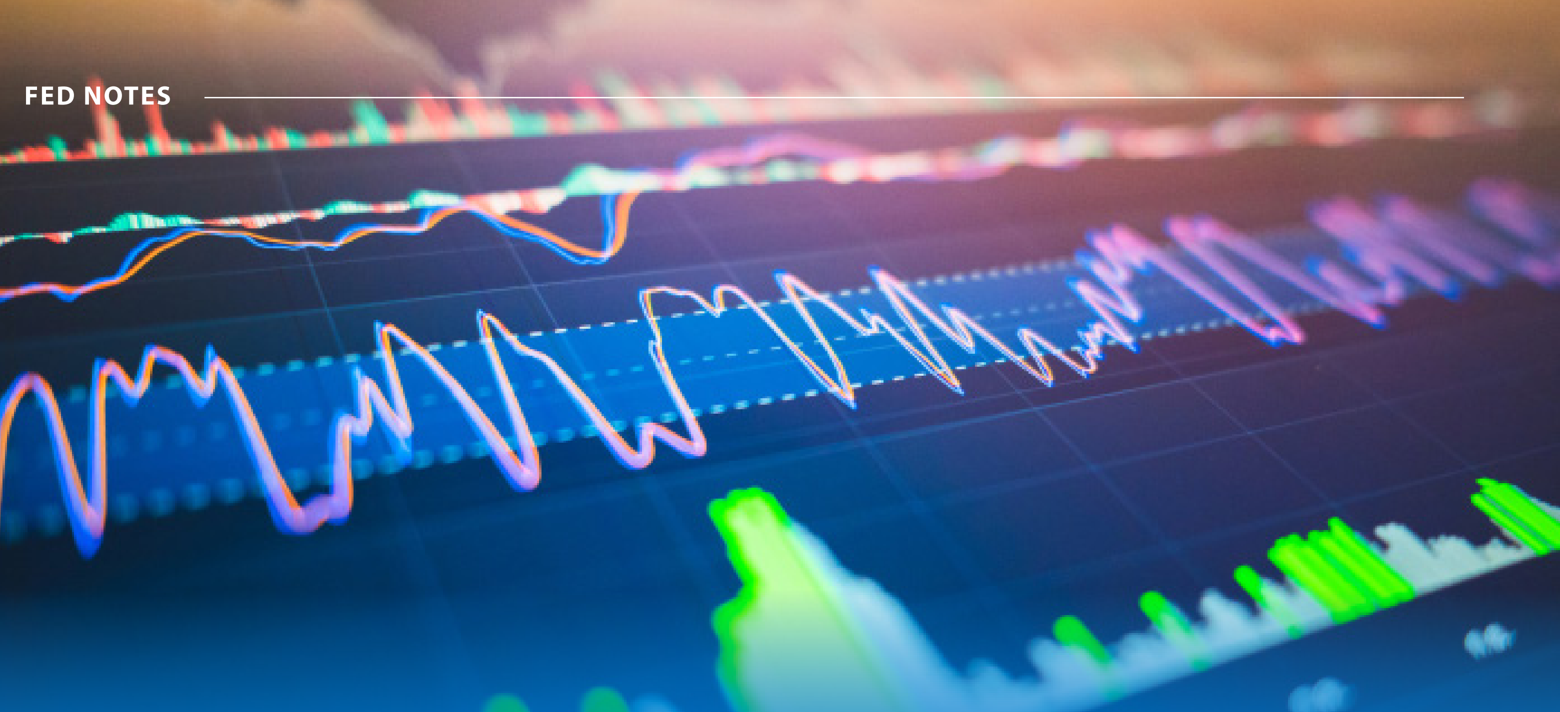










A FED GOVERNOR'S ECONOMIC OUTLOOK

Editor's Note: Fed Gov. Christopher J. Waller spoke Nov. 16, 2022 at an Economic Forecast Luncheon in Phoenix. This is an edited version of his comments.

Christopher J. Waller

Economic growth in the United States has slowed significantly in 2022, and I expect that slow growth to continue into next year. After shrinking slightly in the first half of this year, real gross domestic product rebounded in the third quarter to a 2.6 percent annual growth rate. But all indications are that this was a temporary boost, and that weak growth has returned in the last quarter of this year and will persist into 2023.

Consumer and business spending has softened, amid deteriorating business sentiment in most sectors of the economy and near-record-low readings on surveys of consumer attitudes about the economy. There is no secret about why—inflation is very high, something people are reminded of every day when they see the prices of things they buy go up. On top of that, higher interest rates are raising borrowing costs for businesses and households.

At any other time, I would be pretty unhappy about slowing growth, but not now. If you believe, as I do, that supply bottlenecks in the economy have mostly abated and that elevated inflation is primarily a function of high demand, then slowing down economic growth is absolutely necessary to bring inflation down to our 2 percent target. This slowing in activity is a sign that actions taken by the Federal Reserve this year to reduce inflation are working.

The Federal Reserve tightens monetary policy to reduce inflation primarily by raising short-term interest rates, which has the effect of boosting interest rates throughout the economy. Higher borrowing costs curtail spending and investment by households and businesses. Since the FOMC pivoted in late 2021 in response to upwardly revised labor data and higher than anticipated inflation data, rates for 30-year fixed-rate home mortgages are up from around 3 percent to 7 percent today. Rates for triple-B corporate bonds have roughly doubled in 2022, and rates on higher yield debt have increased even more. As a result, there is a slowdown in the volume of financing in most markets, with some effect on various prices.

The sector that has seen the most significant slowing is housing. New home construction, and new and existing home sales, which grew strongly before and during the pandemic, have all fallen in 2022. As purchases of homes fall, so does demand for goods that typically accompany purchases—new carpeting, new furniture, new lawn mowers and so on. So slowing home sales will decrease demand for goods that complement the purchase of a new home and that will put downward pressure on the prices of those goods.

Furthermore, housing prices that were increasing at an annual rate of 20 percent as late as May slowed to about a 2 percent rate in October, according to data from Zillow. Housing may be the first but won't be the last sector of the economy where higher interest rates will have the effect of dampening demand and will ultimately help moderate price increases. Our goal is to rein in demand, bringing demand and supply into better balance, which will help reduce upward pressure on inflation.

One sector where improving this balance will be crucial is the labor market. Even as economic output has slowed, the labor market remains very tight. While there was roughly one job vacancy for every job seeker in what was a strong labor market before the pandemic, now there are almost two jobs for every person looking for work. Wages have been rising more quickly than they have in decades, much faster than productivity growth plus 2 percentage points that I think of as consistent with the FOMC's 2 percent inflation objective. But I do see tentative signs of some cooling in the labor market, which is vital to keep rising labor costs from putting upward pressure on inflation.

Let me now turn to the outlook for inflation. Last week's consumer price index (CPI) report was a very welcome moderation in the pace of increasing prices. Headline inflation rose 0.4 percent from September to October, the same pace as the month before, and was up 7.7 percent over the previous 12 months, down from 8.2 percent in September and 9.1 percent as recently as June. Core CPI, which excludes food and energy prices, increased 0.3 percent in October from September, a marked step-down from the 0.6 percent readings in the previous two months and the average of 0.5 percent over the first nine months of 2022. On a 12-month change, core inflation came in at about 6.3 percent, down from 6.6 percent the previous month. The step down in October was widespread, involving both a deceleration in services prices and the first decline in core goods prices since March.

Inflation remains too high relative to the FOMC's target, and I thought it would be helpful to offer some detail of what I will be looking at to see continuing improvement in the inflation outlook. One area is goods inflation, where there was a widespread deceleration across durables and nondurables in October. With drops in core import prices and processed materials excluding food and energy over the past few months, I'm looking for continued downward pressure on core goods prices going forward.

Housing, which is a large share of expenses for households, is another sector I will be watching closely in the months ahead as an indicator of the direction of overall inflation. As I discussed in a recent speech, escalating rents have played a large role in driving up inflation this year, and because turnover of leases occurs only periodically, I expect measures of rents and the equivalent for homeowners will continue to increase significantly for at least several more months. But I will be watching for signs of moderation.

Finally, I will be looking for a slowing in price increases in non-housing services, which have been quite robust in recent months and running at about twice their pre-pandemic level. As I said a moment ago, the inflation outlook for this sector will partly depend on the growth of wages. I will be looking closely for continued slowing in wage growth back to a more sustainable rate. Given that medium- and longer-term inflation expectations remain stable, an indication that investors and consumers retain confidence in the Fed's commitment and ability to achieve its inflation goal, I believe we can expect wage growth to slow.

I am going to take a considerable risk here and employ an airplane simile to illustrate how I think of our past policy actions and where we are going. When an airplane is taking off, the pilot fires the engines as much as possible to get off the ground. The goal is to get to cruising altitude quickly, so the initial ascent is steep. But as the plane gets closer to cruising altitude, the pilot slows the rate of ascent, while continuing to climb. The final cruising altitude will depend on many factors, most notably details about the weather. Turbulence may force you to a higher or lower altitude, but you adjust as you go to have a smooth ride.

This is similar to our policy actions this year. When the Fed was faced with rapidly escalating inflation and a strong labor market, it lifted rates aggressively off the effective lower bound including several 75-basis-point steps. But as the policy rate gets higher, the stronger is the case for slowing the rate of ascent while continuing to climb. This would correspond to slowing to 50-basis-point hikes. At a certain point, policy will reach an optimal cruising altitude, but we don't know exactly what that level will be because it depends on the data. Maybe new data will point to a shallower climb and a lower cruising altitude, which would suggest stepping down to 25-basis point hikes. Or maybe it could be necessary to continue climbing a little longer to a higher final attitude by implementing a sequence of 50-basis point hikes. In the end, the higher we raise the policy rate, the more pressing it is to think about the terminal rate and how policy should be adjusted to get there, but that will depend on the incoming data.

Looking toward the FOMC's December meeting, the data of the past few weeks have made me more comfortable considering stepping down to a 50-basis-point hike. But I won't be making a judgment about that until I see more data, including the next PCE inflation report and the next jobs report.

So, although I believe we are seeing some progress in the economy to dampen demand that will help moderate inflation, we have not yet made enough progress. As I have said recently, I expect that getting inflation to fall meaningfully and persistently toward our 2 percent target will require increases in the federal funds rate into next year. We still have a ways to go. Until then, I support continued rate increases and ongoing reductions in the Fed's balance sheet to restrain aggregate demand. When we reach our terminal rate, how long we stay at that level will largely be driven by our progress in bringing down inflation. ■

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

▷ Capra Financial Inc., Montezuma, Iowa filed to become a bank holding company by acquiring Peoples Savings Bank, Montezuma.

▷ Scenic Community Bancshares Corporation, Iowa Falls, Iowa, filed to become a bank holding company by acquiring Iowa Falls State Bank, Iowa Falls. Also, FSB Financial Services, Inc., Waterloo, Iowa, filed to acquire shares of Scenic Community Bancshares Corporation and thereby acquire shares of Iowa Falls State Bank.

▷ Elizabeth J.C. Brennan, West Des Moines, Iowa filed to become the largest individual shareholder and join the Brennan Family control group, and to acquire shares of Morning Sun Bank Corp., and thereby acquire shares of Bank, both of Wapello, Iowa.

▷ Bradford Bancorp, Inc., Greenville, Ill., filed to merge with Community Bancshares, Inc., Irvington, Ill., and thereby acquire Community Trust Bank, Irvington.

▷ Bernard Bennett Banks, Evanston, Ill., filed to acquire shares of National Bancorp Holdings, Inc., and thereby acquire shares of The Federal Savings Bank, both of Chicago.

▷ Frank L. Farrar and Patricia J. Farrar 2022 Irrevocable Trust and others, filed to acquire shares of Capitol Bancorporation, Inc., Britton, S.D., and thereby acquire First National Bank, Ft. Pierre, S.D. The group also filed to acquire shares of Fulda Bancorporation, Inc., Britton, and thereby acquire First National Bank, Oldham, S.D. Furthermore, the group filed to acquire shares of Beresford Bancorporation, Inc., Britton, and thereby indirectly acquire First Savings Bank, Beresford, S.D.

▷ FVSB Mutual Bancorp, MHC and FVSB Bancorp, Inc., both of Fond du Lac, Wis., filed to become a mutual bank holding company and mid-tier stock bank holding company, respectively, by acquiring all of the stock of Fox Valley Savings Bank, Fond du Lac, in connection with the conversion of Fox Valley Savings Bank from mutual to stock form.

▷ Hoosier Heartland State Bancorp ESOP, Crawfordsville, Ind., filed to become a bank holding company by acquiring Hoosier Heartland State Bancorp and thereby acquiring Hoosier Heartland State Bank, both of Crawfordsville.

▷ WSB Financial, Inc., Leesburg, Fla., filed to become a bank holding company through the acquisition of J&M Bancshares, Inc., and thereby acquire The Walton State Bank, both of Walton, Kan.

▷ The Debra Wrobel Trust, Glencoe, Ill., and others filed to acquire shares of Amalgamated Investments Company, Chicago, and thereby acquire shares of Amalgamated Bank Chicago.

▷ Change in control notice filed by Mark Jon Vis, Worthington, Minn., to acquire control of First State Bank Southwest KSOP Plan and Trust, Worthington,which controls 25 percent or more of First Rushmore Bancorporation, Inc., Worthington. First Rushmore, Inc., controls First State Bank Southwest, Pipestone, Minn.

▷ Elevation Bancshares, Inc., St. Louis, authorized to become a bank holding company by acquiring The First National Bank of Sedan, Kan., through Elevation's newly formed interim bank, Elevation Interim National Bank, which will merge with and into The First National Bank of Sedan.

▷ Thumb Bank & Trust, Pigeon, Mich., filed to merge with Exchange State Bank, Carsonville, Mich., and to thereby establish six branches.

▷ VisionBank of Iowa, Ames, Iowa, filed to merge with Legacy Bank, Altoona, Iowa.

▷ Highland Bancshares, Inc., Saint Michael, Minn., filed to acquire Boundary Waters Bank, Ely, Minn.

▷ National Bank Holdings Corporation, Greenwood Village, Colo., authorized to merge with Bancshares of Jackson Hole, Inc., Jackson, Wyo., and to thereby acquire Bank of Jackson Hole, Jackson, and for NBH Bank, Greenwood Village, to acquire Bank of Jackson Hole's 12 branches.

▷ First Waterloo Bancshares, Inc., Waterloo, Ill., filed to merge with Village Bancshares, Inc., Saint Libory, Ill., and thereby acquire The Village Bank, Saint Libory.

▷ First Iowa State Bank, Albia, Iowa authorized to merge with First Iowa State Bank, Keosauqua, Iowa.

▷ Bancorp of New Glarus, Inc., New Glarus, Wis., filed to acquire First National Bank at Darlington, Wis.

▷ Sword Financial Corporation, Horicon, Wis., filed to acquire Community Bancshares Wisconsin and thereby acquire Cornerstone Community Bank, both of Grafton, Wis.

▷ Notice filed by KJ Jansen, LP, and Robert G. Willenborg, both of Effingham, Ill., to acquire 10 percent or more of the shares and thereby control of Prime Banc Corp., Effingham, the parent company of Dieterich Bank, Effingham.

▷ Tyler Engstrom, Westhope, N.D., filed to acquire shares of Peoples State Holding Company, Westhope, and thereby acquire of Peoples State Bank, Westhope.

New to BHCA

The Bank Holding Company Association is pleased to welcome a new Associate Member:

DCNB Holding Company
Dan Sievers, Secretary
Gary G. Keller, Board Member
Clear Lake, S.D. DNB National Bank

President's Observation, *Continued from page 4*

Thank you for being involved and attending the seminars. Many of you shared opinions about potential speakers for future events or on other topics, and I thank you sincerely for your engagement. Your support has made this a great organization and it humbles me to think about my opportunity to serve on the board and to fill the role of president.

Let me conclude this column and my year as president with a request: If you know a fine banker who is not a BHCA member, please invite them to join the association. Sometimes people need a personal invitation before they will consider joining an organization. Be the person to extend that invitation. While we have healthy membership, there are still many holding companies in the region that are not members. I think as the industry consolidates, it will become even more important that those of us in the industry continue to come together, share knowledge and help each other as much as we can through organizations such as the BHCA.

As we conclude the year, I wish you all well. I hope you have a joyous Christmas season, and I look forward to a great 2023. ■

As new year approaches, BHCA Board of Director seats change

Three bankers were elected to the Bank Holding Company Association Board of Directors at the association's annual meeting conducted Oct. 3 in conjunction with the Fall Seminar. Joining the Board Jan. 1, 2023 to begin three-year terms are:

- **Laura Meyer Dick**, First Kansas Bancshares, Hutchinson, Kan.
- **Kelly Rachel**, North Star Holding Company, Jamestown, N.D.
- **Ella Meyerson**, Cattail Bancshares, Inc., Atwater, Minn.

The bankers are filling vacancies that will be created when three bankers conclude their terms of service on Dec. 31, 2022. They are:

- **Mary Jayne Crocker**, Bridgewater Bancshares, Inc., St. Louis Park, Minn.
- **Michael Segner**, Peoples Bankshares, Inc., Mora, Minn.
- **Brenda Johnson**, Charter Bankshares, Inc., Eau Claire, Wis.

Crocker and Johnson began their service on the board in 2016. Johnson served as BHCA president in 2018 and Crocker served as president in 2021. Segner began his service on the board in 2017.

Meyer Dick is vice president of First Kansas Bancshares, a title she has held since 2010. She serves on the board of First Kansas Bancshares, as well as on the board of Nebraska Bank of Commerce, Lincoln, Neb. She is a 2018 graduate of the Graduate School of Banking at Colorado.

Rachel is president/CEO of Unison Bank and its North Star Holding Company. He is a 1994 graduate of the Graduate School of Banking in Colorado. Unison Bank, with assets of $580, has three offices in North Dakota and one in Arizona.

Meyerson is responsible for marketing at the holding company's two banks: Harvest Bank, Atwater, and Citizens State Bank of Waverly, Minn. She is a shareholder at Cattail Bancshares, Inc., serving as its secretary/treasurer since 2009. She is a 2011 graduate of the Graduate School of Banking at the University of Wisconsin-Madison.

At the November board meeting, the BHCA Board of Directors elected the following to officer positions for 2023:

- **President:** Denise Bunbury, State Bankshares, Inc., Eau Claire, Wis.
- **Vice President:** John Healey, Crown Bankshares, Edina, Minn.
- **Treasurer:** Scott Bullinger, Bravera Holdings Corp., Dickinson, N.D.
- **Immediate Past-President:** Tim Siegle, Ameri Financial Group, Inc., Lino Lakes, Minn.

"We are extremely grateful for the service these bankers put into the Bank Holding Company Association," commented Tom Bengtson, BHCA managing director. "We are especially thankful for the service of the three bankers who are leaving the board after two terms of service. And, we look forward to great things as three bankers join our board and three others move into leadership roles."

Down to Business, *Continued from page 5*

you like your BHCA membership experience, please consider inviting colleagues from your county bankers' group or other professional gatherings to join as well. While our membership is strong, there are still many bank holding companies in the region that are not members.

We love our Associate Members!

Let me also take this opportunity to thank our Associate Members. We have a strong contingent of companies that support our holding company members. Some of our Associate Members have been with us since the earliest days of the association, going back to the 1980s. When we talk about great networking opportunities in this association, we are including the opportunity to connect with many of the finest professionals in companies that serve the banking industry. Whatever service you might need for your bank holding company, you are likely to find multiple options among our Associate Member ranks.

Conclusion

As the year draws to a close, let me express my gratitude to everyone involved with the BHCA. I feel very fortunate to have the opportunity to serve all of you as the Managing Director of this group. 2022 has been a good year – we've celebrated, heard some great messages, met new people, and learned a few things along the way. Thanks to all of you who made it possible. I look forward to a great year ahead as we work together in 2023. ■

SAVE THE DATE

SPRING SEMINAR 2023 | MONDAY & TUESDAY | MAY 1-2

FALL SEMINAR 2023 | MONDAY & TUESDAY | OCTOBER 2-3

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BANK HOLDING COMPANY ASSOCIATION

The BHCA exists to provide education and business connections critical to the vitality of bank holding companies.

INSIGHTS | NETWORKING | SEMINARS

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Years the BHCA has been serving bank holding companies

1,200
Bank owners, directors, officers and vendors who attended a BHCA event in the past few years

200+
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