Road to Recovery

Where Does Banking Go From Here?

By Symone C. Skrzycki

It's been a bumpy ride – and it's not over yet. But progress is taking place.

That was the prevailing sentiment among four longtime bankers who came together to share their perspectives on their industry in the wake of the Great Recession.

A multitude of new government regulations designed to protect consumers and increase transparency has become a thorn in banking's side. Panelists emphasize that while oversight is important, the policies (primarily federal) are cumbersome, ambiguous and raise more questions than they answer.

But there are bright spots. The housing market is beginning to recover nationally. Regional growth is taking place in a variety of industries. In addition, banks are finding innovative ways to serve their customers and communities.

Taking a closer look at banking industry obstacles, opportunities and what the future may hold are:

Our Participants:

- **Brandt Burdick,** senior vice president and group manager, PNC, Indianapolis
- **Bart Colwell,** president and CEO, Terre Haute Savings Bank, Terre Haute
- **Doug Lefferson,** executive vice president and chief banking officer, First Financial Bank, Cincinnati
- **James Rickard,** president and CEO, Community Bank Shares, New Albany

'Drowning in a sea of new regulations'

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) contains the lion's share of regulatory provisions impacting the financial sector and multiple other industries.

Signed into law in 2010, the legislation encompasses 398 rulemaking requirements. According to a leading Washington newsletter for the finance industry, "regulators are a long way from catching up with the two-and-a-half-year-old Dodd-Frank Act and banks' compliance race is really just getting started."

As of early January, a total of 237 rulemaking deadlines had passed – regulators missed 60% of them. Moreover, regulators' proposals for some of those "missed" rules had not yet been finalized.

Indeed, the "finish line" is nowhere in sight as banks struggle to keep a steady pace, given the magnitude – both in number and scope – of the reform measures.

"Because there's a lot of 'question throwing,' the banks have to work with the compliance side of it," Burdick asserts. "There's a lot of ambiguity around the definitions. We could have four different definitions around this table about what we think a qualified mortgage is (for instance) and we're reporting to similar entities on that."

Adhering with the regulations is a juggling act. Besides interpreting confusing language, there are staff resources and potential investments (many which bankers argue are unnecessary) to consider.

"I think if you would talk with most banks, particularly the smaller banks, they're going to say that they are drowning in a sea of new regulations that really seem purposeless," Colwell declares.

"We're a $300 million bank. We have four-and-a-half people whose job is compliance – not waiting on customers, not selling products – just making sure that we comply with all of the consumer regulations. That seems a bit excessive to me."

Burdick seconds the idea that striking a balance isn't easy.

"How do you find this happy medium of serving your customer base, your shareholders and the communities that you're in? It's unprecedented and I can't imagine a more turbulent timeframe."

Rickard expresses concern over another issue arising from the new safeguards.

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"I think there have been a lot of unintended consequences in that the very people that the additional regulations appear to want to protect are the ones that get hurt," he maintains. "We're in unchartered times, both economically and in compliance."

Lefferson agrees, citing a global initiative called Basel III (issued by the Basel Committee on Banking Supervision) that requires lenders to more than triple their minimum level of core capital.

"It isn't intended to shut down home equity lending or second mortgage lending, but if you look at the way the capital requirement is now, it could have a very dramatic effect on the way we do lending," he contends.

Burdick chimes in, "That's a great example. We were supposed to be Basel compliant, certain banks, by the end of 2013. Everyone's been working to get to that date. (Then), they come out and say, 'Oh, that's not really realistic' and pushed it out to 2019.

"There's this lack of clarity and coordination throughout the whole effort."

"We're fortunate to be in a state that has been progressive over the last few years in trying to create a healthy business environment, and I think that bodes well for the future of banking in Indiana and Indiana as a whole."

James Rickard
Community Bank Shares

Businesses battling uncertainty

Post-financial crisis, banks have been criticized for excessively scaling back the capital they provide for commercial loans. But muted interest is the primary factor in curbing loan activity, panelists contend.

"Our customers are telling us that they don't know what their health care is going to cost. They don't know what taxes are going to be," Rickard reveals. "We (banks) all are heavily regulated, but even a small business is seeing additional regulation. There's just a lot of uncertainty, so they're not buying new equipment. They're not expanding. They're not hiring."

Burdick notes that at PNC, the state's second largest bank in terms of deposits in branches, "there is this desire to put our capital to work, to assist the community, to assist the individuals. But clearly demand is softer than it has been."

He anticipates that the market eventually will pick up and the industry will benefit from "pent-up demand"; after all, businesses will have to invest in machinery and technology to remain competitive.

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On the residential side, historically low interest rates are fueling activity – especially refinancing.

"There are still transactions of buying and selling homes (in our area)," Colwell remarks. "It's up better than it was at the low point, but it's not back where it was in 2005, 2006. And we were in an area that was, I think, overly inflated on home values.

"How do you find this happy medium of serving your customer base, your shareholders and the communities that you're in (dealing with new government regulations)? It's unprecedented and I can't imagine a more turbulent timeframe."

Brandt Burdick
PNC

"But when people can finance their mortgage from 6% down to 3.5%, and help improve their cash flow a bit, it does give them the opportunity either to pay off some other debt with that extra cash or go out and use those funds to buy things and then that helps the economy overall."

It's a positive development, but one that also brings obstacles for financial institutions.

"We have lowered (interest rates) about as low as we can go, and our return on what we're selling – our loans – continues to drop," Lefferson comments. "It becomes challenging. You've got to think about, 'What are we getting paid for the risk at levels that low?' At least that's something I think about."

Colwell echoes that sentiment.

"In order to overcome and compensate for some of those additional costs, you've got to watch making long-term loans that are funded by increasingly shorter-term deposits," he emphasizes.

Beyond 'brick and mortar'

While branches remain vital for some customers, technology is changing the "face" of banking.

Online banking has exploded in popularity in recent years. Now, mobile banking is growing tremendously – especially among young adults.

"My (college-age) daughter banks with this," Burdick shares as he points to his mobile device. "She doesn't know where the bank is and doesn't have any desire to go there, so we have to figure out ways where she (and those with similar preferences) can make a deposit of a check on her phone or go to a remote ATM and actually cash a check."

Your Community Bank operates primarily in metropolitan Louisville. Headquartered in New Albany, it's the largest independent bank in Floyd and Clark counties. Community Bank Shares also includes Scott County State Bank in Scottsburg.

During the past five years, customer transactions at its branches decreased approximately 5% annually. Consequently, the bank has increased its focus on online services.

"We have to continue to invest in technology because it's constantly changing and the ways our customers want to be served is constantly changing," Rickard stresses. "We like to think that we're a little bit on the leading edge of technology for banks our size, but it requires a lot of analysis and evaluation. It would be very easy to spend a lot of money on technology that really brings no value to your customers because, again, it's constantly changing and new things are coming out."

"If you enjoy working with people and helping them succeed even with all the challenges, there's always going to be opportunities out there to do that and it's a very important part of the economy."

Doug Lefferson
First Financial Bank

Like other consumers, small business customers are embracing new technology.

"Today, you have remote deposit where many of our small businesses don't come to the branch anymore," Rickard states. "That is an enhancement for the customer because they no longer have to take the time or send someone to the branch. They're making their deposits from their office at a time that's convenient for them.

"Many of the payments they receive now are done electronically, so there aren't a lot of checks floating back and forth like there was historically. That's changed for small businesses."

Lefferson remarks that more and more businesses of that size are "going global."

"They're using technology the same way consumer clients are and it's to the advantage of both of us. It used to be that a small, mid-size business may just deal more locally here. We're starting to see more of an international flavor."

Delivering the services customers are demanding is just one challenge. Providing them in a

safe, secure environment is another.

"Wherever there is money or access to money, there will be people who will try and get it through inappropriate means – whether it's John Dillinger back in the '30s or whether it's computer hackers now in 2013. You always have to be alert to that and make sure that your protection is keeping up with technological access," Colwell notes.

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Bart Colwell
Terre Haute Savings Bank

Making a difference

Financial institutions play an important role in building vibrant communities. Many promote volunteerism among their employees and partner with charitable organizations.

"I think bankers generally have a real passion for the communities they're in," Rickard offers, "and for the community to be healthy, there needs to be healthy banks in a community."

Your Community Bank Community Foundation promotes education by providing scholarships, working with Junior Achievement (a volunteer-based organization that educates students about workforce readiness, entrepreneurship and financial literacy) and collaborating with local schools, universities and colleges. Meanwhile, the PNC Foundation has dedicated $350 million to early childhood education (birth to age five) nationwide.

"There are statistics to show that when you kick-start the educational process and the reading and writing – the basics – it does pay dividends long down the road," Burdick comments.

Housing initiatives are a focus at Cincinnati-based First Financial Bank, Indiana's 10th largest bank by size. Examples include collaborating with the Indianapolis Neighborhood Housing Partnership and Habitat for Humanity.

Banking, Lefferson asserts, is about people.

"From my perspective, it's still very much a relationship business and it's a people business. If you enjoy working with people and helping them succeed even with all the challenges, there's always going to be opportunities out there to do that and it's a very important part of the economy."

Terre Haute Savings Bank also challenges its employees to make a difference.

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"We encourage our staff to find a passion and be involved – whether it's United Way or a school, maybe it's counseling domestic abuse (victims) – whatever (that may be)," Colwell contends. "We all talk about wanting our communities to be a great place to live. You know what? It's up to us to do that."

Bouncing back

As the dust begins to settle, industries such as housing, health care, logistics and automotive are rebounding throughout the state.

"We have one hospital that's expanded tremendously; the others are doing well," Colwell reflects. "Some new practices are coming into the area, so that's a bright spot for the Wabash Valley. Also, we have a couple of automotive suppliers and they have hired over the last couple of years."

Growth in the housing market, Burdick says, is starting to pay off.

"There are some new developers that are out there starting projects, which means they're hiring people, which means people have take-home pay. It kind of works its way through the system," he observes. "While it's modest (growth), it's moving in the right direction. I think we show great optimism there."

Rickard concurs. "Through '08 and '09, residential housing got hit pretty hard in our area, but it rebounded. It's not back to where it was, but it's healthy again," he affirms. "Southern Indiana and metro Louisville is pretty stable. I just read in the last week or so that home values in our metropolitan market are up around 10% over the same count as last year. So, we're seeing some recovery."

"I agree with my colleagues' points (that) there's been stability in the region," Lefferson asserts. "We (at First Financial Bank) see that in Ohio and Indiana and northern Kentucky as well.

"We certainly had more of a cushion when things changed, and I think there's more diversity in this region than what people realize."

Indiana's progressive nature also has helped buffer the fallout from the economic downturn. Passage of right-to-work legislation in 2012 has huge potential to attract new industry – and jobs – to the state.

"All of a sudden, we see an influx of opportunities from the IEDC (Indiana Economic Development Corporation) and business looking (to come here), and Michigan quickly passes a right-to-work law as they see opportunities leaving," Burdick comments. "So the idea you can do things in a different manner, we've got a great example right here."

He suggests that the state's sound business practices are helping the majority of its financial institutions in their recovery.

"While there were certainly instances of Indiana banks that had more issues than others, it wasn't like on either coast, and it wasn't everybody kind of getting happy on the commercial real estate stuff and doing things all over the country. I think the conservative nature of the state of Indiana – whether it be the banking side or the business side – led to keeping everyone's nose clean on that."

Rickard sums it up:

"Indiana banks are strong and we are here to serve our communities, but the banking (industry) is only as strong as its customer base. We're fortunate to be in a state that has been progressive over the last few years in trying to create a healthy business environment, and I think that bodes well for the future of banking in Indiana and Indiana as a whole."