

RMA Community Bank Survey 2021





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EXECUTIVE SUMMARY

The unique events of the past year presented community banks with unprecedented challenges, yet many lenders demonstrated significant resilience and nimbleness for their borrowers amid the public health crisis.

From new industry standards to technological advancement, this velocity of change has served as a wake-up call for many community bank leaders looking to the future. The 2021 RMA Community Bank Survey offers a glimpse into what community banking leaders have on their minds and their sincere answers to what is next for community banks.

Our findings show that senior executives are focused on accelerated digital transformation across the industry, with cybersecurity and IT risks top risk management issues this year.

Staffing was another concern. According to the 2021 survey, more of the banking workforce will return to the office soon. Yet, the respondents saw retaining and attracting talent amid the current banking environment as an increased risk factor.

The executives also noted the net interest margin (NIM) as a critical factor in banks' profitability. The NIM for community banks narrowed further during the first quarter of 2021 as the continued reduction in average earning asset yields outpaced the decline in average funding costs, Federal Deposit Insurance Corporation (FDIC) data showed.

As most of the community banks participated in the Paycheck Protection Program (PPP) loans, the respondents said that they experienced a lack of clarity in guidelines around the treatment of the CARES Act loans and deferrals, to a degree.

The survey also found that respondents collaborating with fintech firms did so mostly in cash management services. Respondents considering collaborating with fintech companies planned to do so in small business loans.

Many of the banking executives have been in search of opportunities to expand their businesses into new markets for future growth and increase the value-add to the stakeholders. The 2021 survey results suggest that post-pandemic, community banking may require leaders to seek new approaches for the lasting success of the banking business as well as value-adds to the customers.

One note: we experienced a decreased participation rate in the 2021 survey, with 65 unique responses. The pandemic may have distracted additional participants, yet there are valuable findings and intriguing trends to be gleaned from the 2021 results.

The PDF version of the Community Bank Survey provides a preview of the data. Complete survey results will be made available to all survey respondents.

Key Findings

At a glance

Chapter 1

6.7% say regulatory demands resulted in increased costs. Cyber, IT, and data security are main sources of risk.

Chapter 2

The CARES Act and the Community Reinvestment Act (CRA) have become top focus areas for regulators.

Chapter 3

Most of the participating banks do small business lending and make SBA loans.

Chapter 4

40.3% say they are ready for the CECL implementation or close to it. 95.3% of the respondents participated in PPP lending and the majority began proceeding with PPP forgiveness in 2021.

Chapter 5

32.8% report their institutions are likely to acquire or merge with another in the next two years. 17.2% say their institutions are likely to be acquired or enter into a merger agreement.

Chapter 6

All respondents say remote working is a partial option as staff needs to return to the office in the post-pandemic world.



Chapter 1: Risk Management

In our 2021 survey, cybersecurity risk, IT risk, and regulatory and compliance risk were ranked highest both in difficulty to implement and most demanding on bank's management.

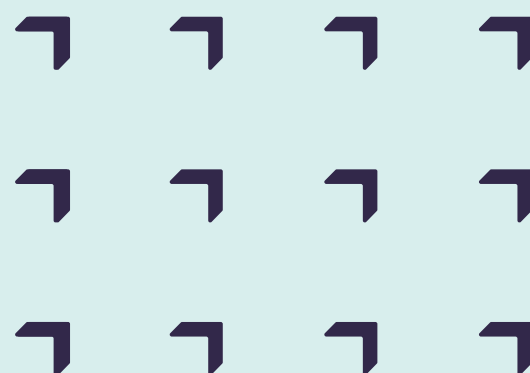
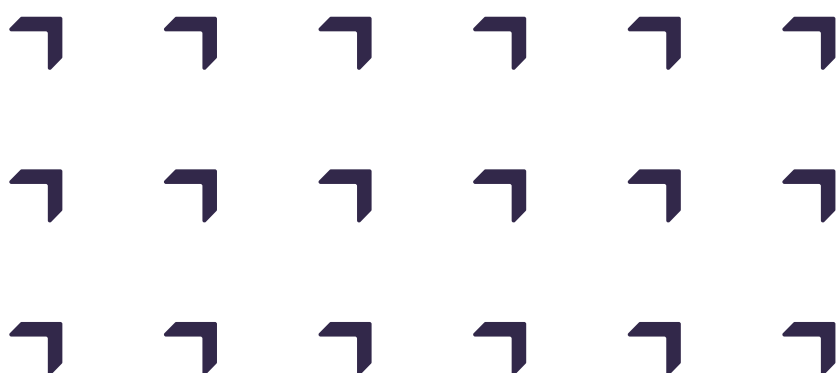
Cybersecurity risk is relatively new to the industry and continues to evolve at a rapid pace. In addition, enhancing the cybersecurity capacity for banks requires management to plan for the longer term with multiple steps that typically require firm-wide approaches.

A key change this year: Participating bank executives were asked to rate the difficulty in implementing plans to address various risks, as opposed to rating areas of risk based on importance. In our past surveys, credit risk was considered the top risk for banks because it can significantly impact the bank's performance.

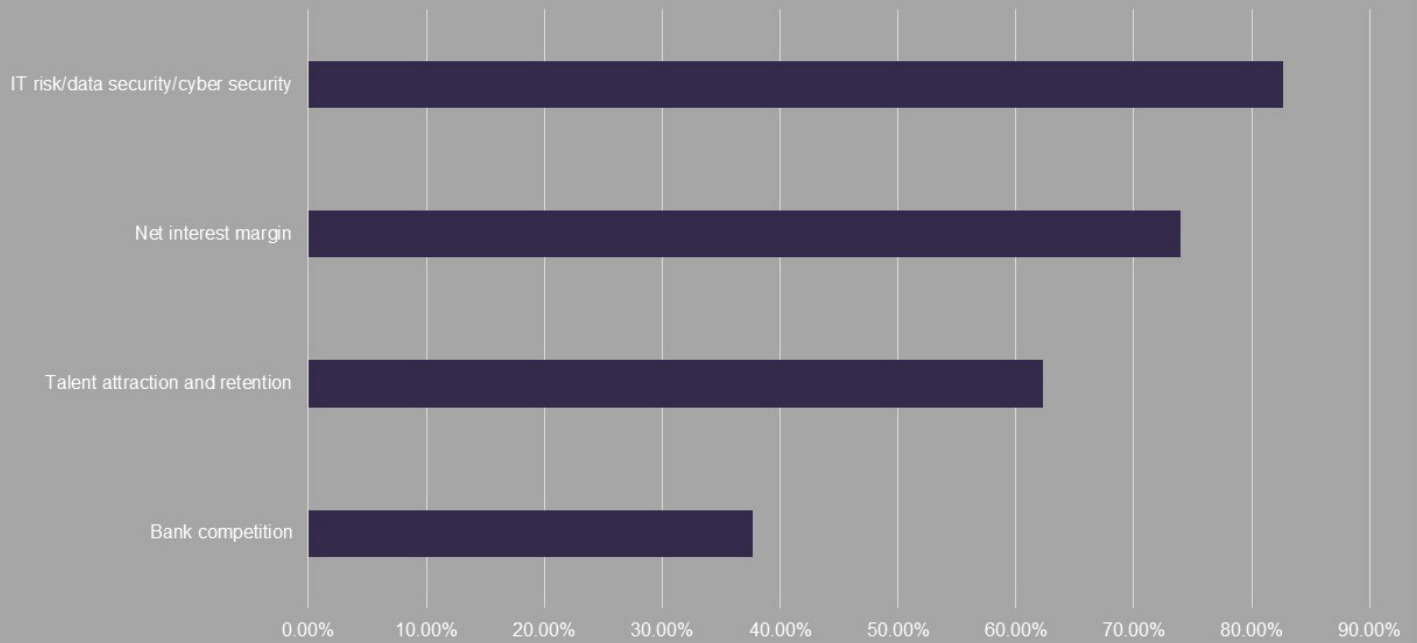
Cybersecurity risk is no longer a passive matter.

"You can expect banks to see increased cyber risk and therefore increased cyber risk budgets over time."

.....
Christopher Hetner, former Senior Cybersecurity Advisor to the SEC Chair; current Senior Cyber Risk Advisor to the NACD



What are the top five factors in your internal or external environment that most threaten your bank's success over the next 12 months? (Please only check five)



Answered: 65 Skipped: 0

The fifth top risk factor in our survey was a tie between "Local & national economy," "Compliance," and "Lack of growth." at 33.33%

Additionally, we asked participating bankers to project the top risk factors in the banking environment over the next 12 months. The results continued the focus on cyber and technology-related risks:

- IT risk / data security / cybersecurity (83%)
- Net interest margin (75%)
- Talent attraction and retention (65%)

The top challenge to the profitability of banks was the net interest margin (NIM), the spread between asset yields and funding costs for deposits and other borrowings. In fact, a continuing low-interest-rate environment caused a yearly reduction in earning asset yields for many banks. For example, the net interest margin for community banks was 3.25% during the first quarter of 2021, according to *The Quarterly Banking Profile*,¹ the latest quarterly analysis provided by FDIC. And the FDIC's 2020 Community Banking Study indicated the net interest margin for community banks peaked at about 3.8% in 2018 and has been in a downturn since 2018.²

1 <https://www.fdic.gov/news/press-releases/2021/pr21083.html>

2 <https://www.fdic.gov/resources/community-banking/report/2020/2020-cbi-study-full.pdf>

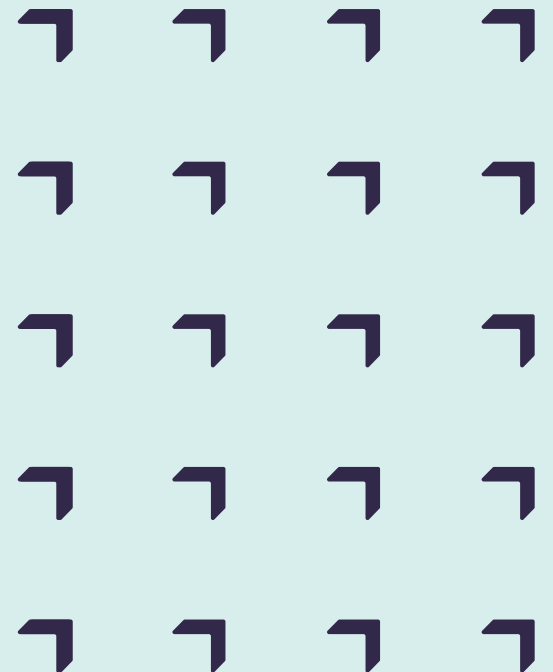
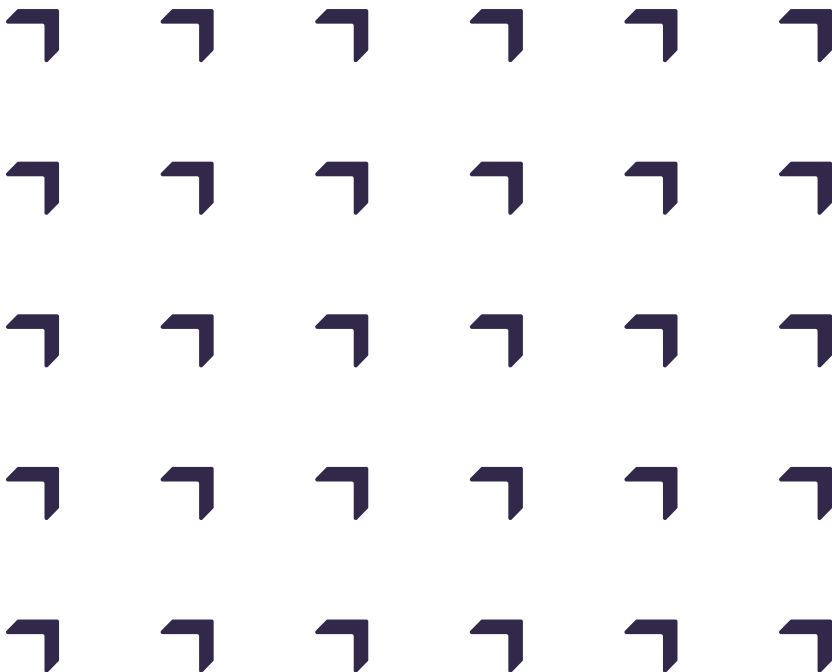
For the participating community banks, the diminishing earning asset yields may have longer-term impacts. "In community banking, there has always been a balance between maximizing NIM, loan growth, and competition for deposits. But in the current environment, there really isn't competition for deposits because most banks have excess liquidity," added Kevin Bastuga.

Lastly, talent attraction and retention became one of the top three risk factors, with concerns expressed by the participating banks on retaining and hiring new staff. The remote working environment that emerged amid the pandemic created new staffing challenges, as many banks were challenged to keep staff safe - potentially adjusting many in-person workflows to become virtual, including staff onboarding processes during remote work.

As yields have diminished faster than the pace of the decline in average funding costs, the NIM has been experiencing record lows, which suggests the quality of bank earnings may be at stake.

"The biggest risk for our bank is maintaining loan growth and credit quality in a very competitive lending environment."

.....
Kevin Bastuga, Co-founder/
EVP, Signature Bank





Chapter 2: Regulatory Compliance

Overall, most participating executives believe that the regulatory exams taken shortly before the survey were fair and that the exams were focused on the correct areas.

According to respondents, the top regulatory focus areas are as follows:

- Community Reinvestment Act (CRA) (71%)
- Treatment of PPP, the CARES Act loans and deferrals (66%)
- Fair credit reporting (46%)

The Community Reinvestment Act is an area of focus for regulators. Banks that have CRA³ obligations are supervised by one of three regulators: Federal Deposit Insurance Corporation, Federal Reserve Board (FRB), and the Office of the Comptroller of the Currency (OCC). Each regulator has a dedicated CRA site that provides information to the public about the banks they oversee and those banks' CRA ratings and Performance Evaluations.

On September 17, the OCC proposed changes to CRA regulations to revamp the regulations from an interagency perspective. The proposal would align the OCC's CRA rules with the current Federal Reserve and FDIC CRA rules to facilitate ongoing interagency work to modernize the CRA rules, a public notice of proposed rulemaking⁴ showed.

The Paycheck Protection Program was established by the CARES Act and implemented by the Small Business Administration (SBA), with support from the Department of the Treasury.⁵ About 95.4% of the respondents said that their institutions participated in PPP lending, and 95.3% had begun to process the PPP forgiveness. Many community banks participating in the PPP loans experienced difficulties implementing this new program. SBA guidelines and bank processes used for PPP loans changed and evolved while PPP funds were available. Processing PPP loans occurred as banks were also processing deferrals and modification requests, which burdened many lending support teams at community banks. Some lenders experienced difficulties in determining how to calculate cash flow and debt service coverage ratios of the borrowers who obtained PPP funds.

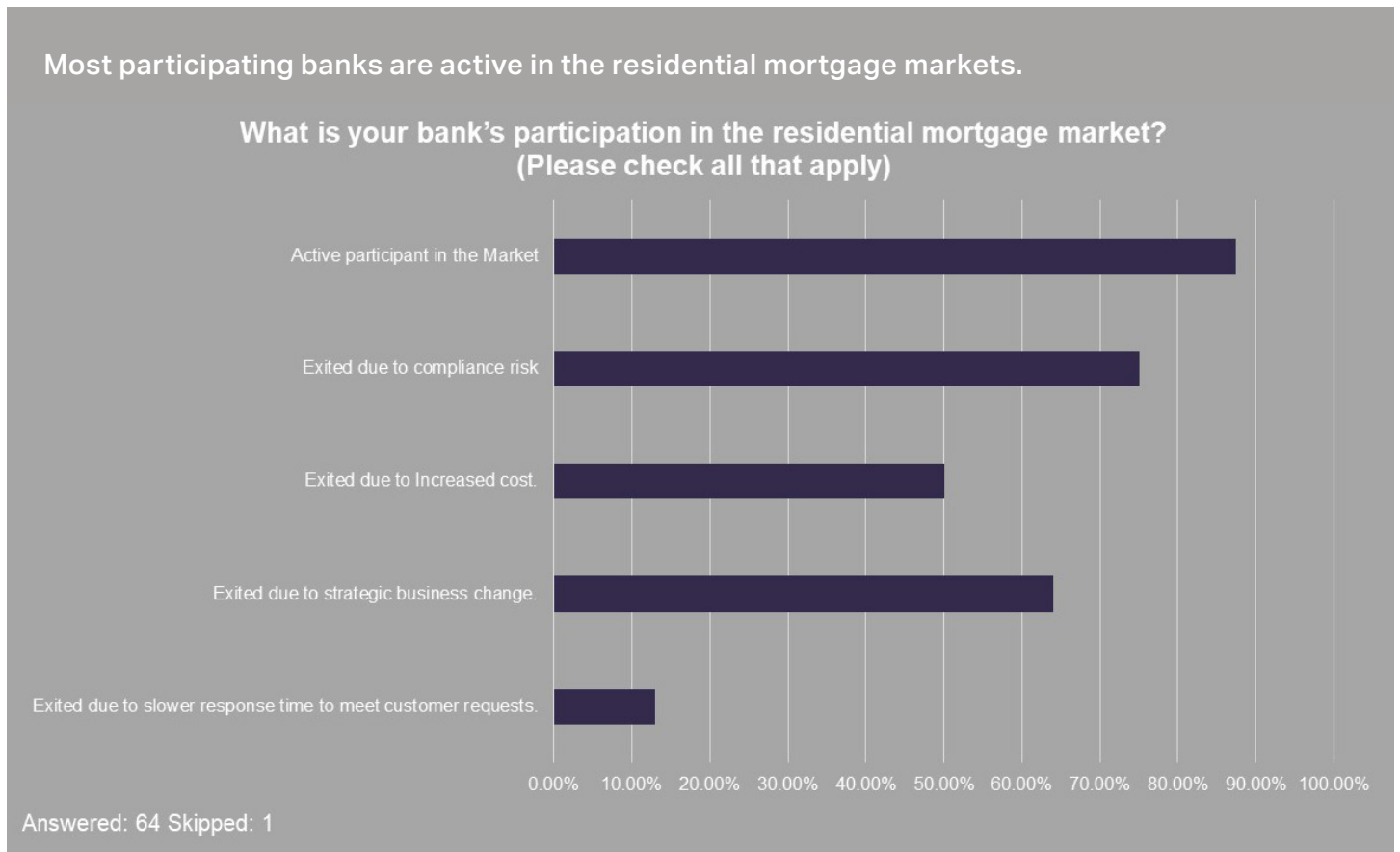
3 https://www.federalreserve.gov/consumerscommunities/cra_about.htm

4 <https://www.federalregister.gov/documents/2021/09/17/2021-19738/community-reinvestment-act-regulations>

5 <https://home.treasury.gov/policy-issues/coronavirus/assistance-for-small-businesses/paycheck-protection-program>

Chapter 3: Growth and Profitability

Participating banks plan to be more active in SBA loans and small business lending. Sector-wise, most respondents said their institutions plan to decrease hospitality financing activities. Also, most participating banks do not offer lending, depository, and cash management services for selected niche areas such as marijuana, oil and gas, and renewable energy.



Most respondents said their institutions are actively participating in the residential mortgage markets. Many institutions offer residential first mortgages and more than 82% of respondents said at the time of the survey that their institutions offered home equity lines of credit (HELOC).

Notably, the survey found that participating banks faced the most data integrity challenges in relation to the latest Home Mortgage Disclosure Act (HMDA) data collection requirements.

In October 2019, the regulators amended the HMDA requirements to provide more comprehensive mortgage market data to the public. Now, certain home mortgage lenders are required to collect, record, and report as many as 110 data collection fields from their loan applicants. The required fields include ethnicity, race, income, credit score of borrowers or loan applicants, and loan term, among others.

Given the increased burden for the lenders on collecting and reporting the data fields, the probability of reporting errors occurring has also been elevated for some lenders. In turn, managing compliance risk has become more important as lenders are navigating through amended HMDA requirements.

Furthermore, the increased burden may lead many to reassess their existing loan offerings although the survey showed that the additional HMDA data reporting requirements have not had a significant impact on banks' participation in residential lending, at this point.

Banks are implementing increased requirements around data privacy and preserving consumer privacy. This additional layer of security requires new infrastructure investment and a heightened sense of risk for banks.

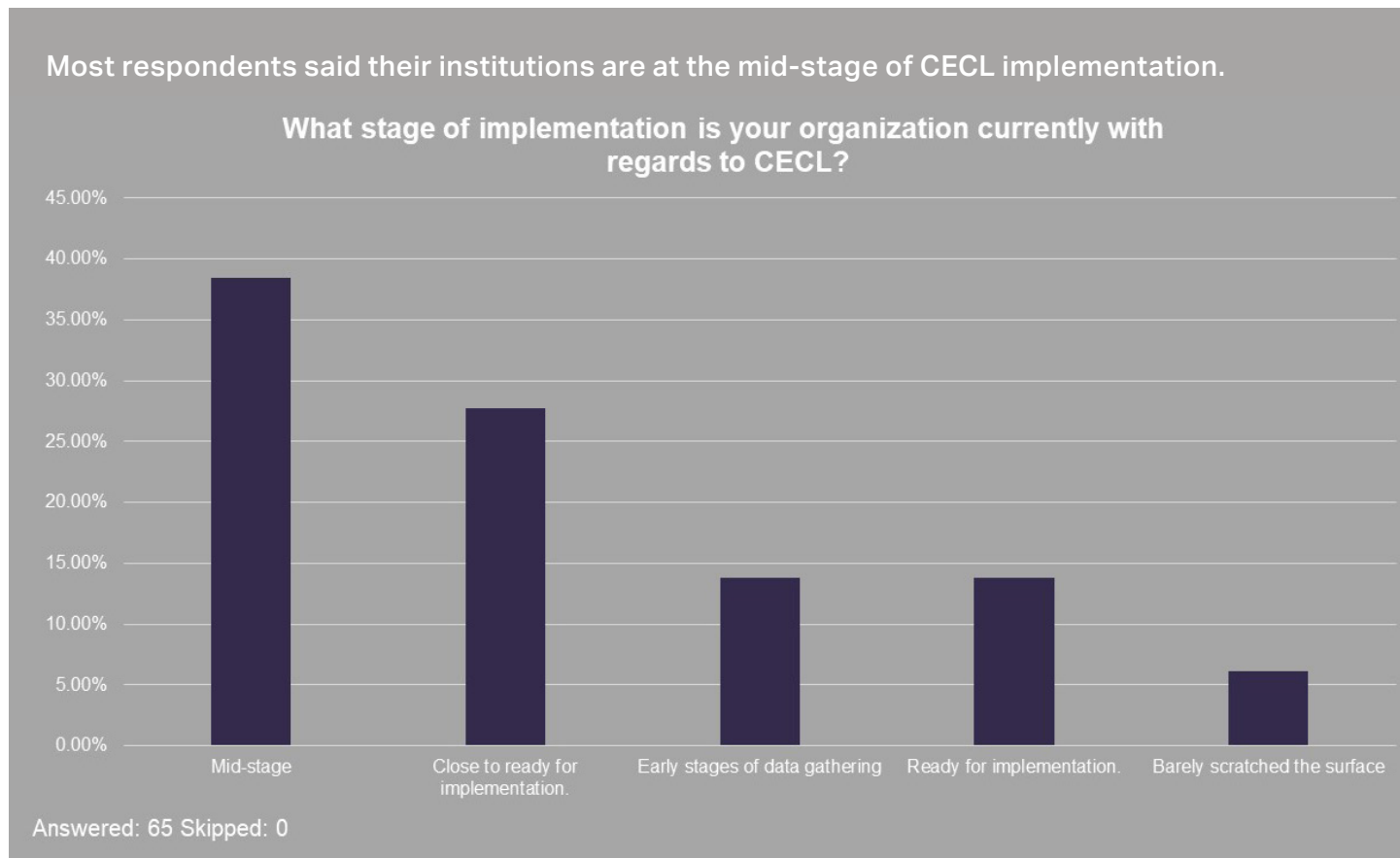
“The combination of all that personal data is expected to be well protected and preserved through the banking regulatory system, particularly within the U.S.”

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Christopher Hetner



Chapter 4: New Standards and Regulations

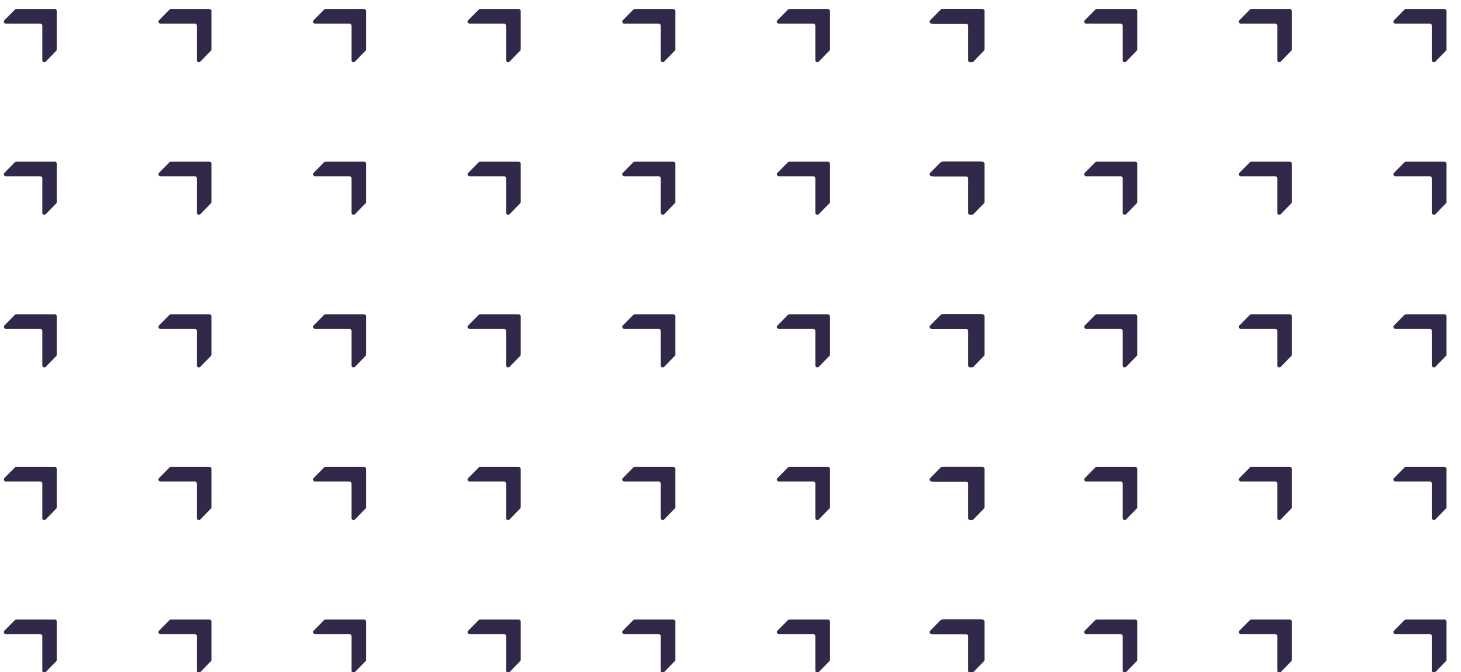
Overall, banks are feeling more confident about the implementation of CECL than they were a few years ago. Most banks (38%) are at the mid-stage of implementation, followed by "close to ready to implement" at 28%. In our previous survey, 48% of respondents indicated they were in the early stages of data gathering. This year, that number dropped to 14%.



However, banks differed in their approach to how they would carry out implementing CECL models. Most banks decided to use a vendor to help with CECL, while 28% are not outsourcing the work. In terms of the calculation methods, discounted cash flow and loss vintage analysis are less likely to be used at 17% and 11%, respectively.

According to respondents, the top picks for CECL calculation methods include expected loss and discounted cash flow methods. However, more than a third of the respondents have not decided on the calculation methods yet:

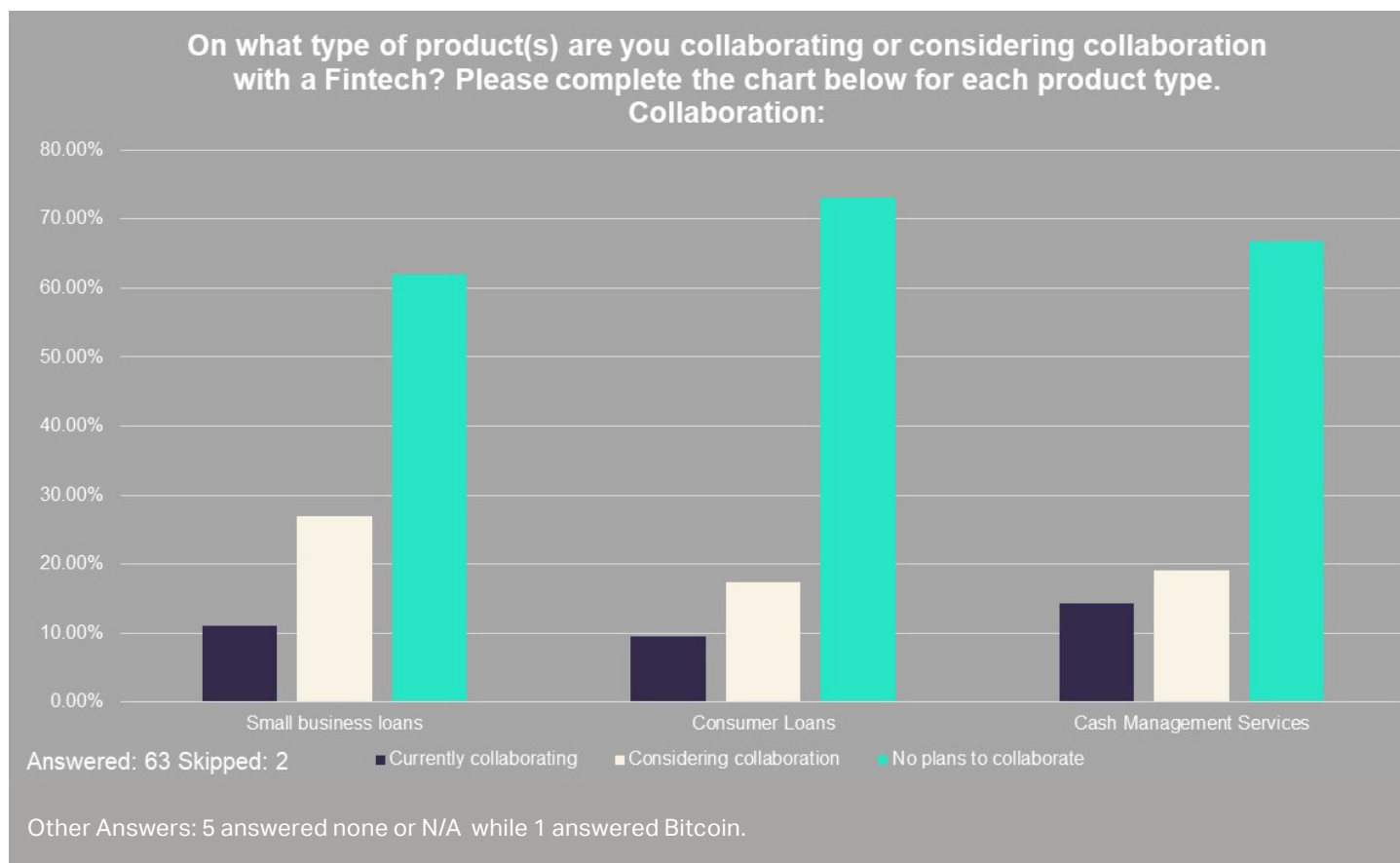
- Expected loss method (37.9%)
- Still exploring (34.8%)
- Discounted cash flow (16.7%)
- Loss vintage analysis (10.6%)



Chapter 5: Innovation

Fintech

In recent years, community banks often collaborate, or consider collaborating, with fintech firms to gain efficiencies in areas such as small business loans, consumer loans, or cash management services. Our findings showed that respondents currently collaborating with a fintech firm were most likely to do so in the cash management services area (14.3%). Respondents considering collaborating with a fintech most frequently planned to do so in the small business loans area (27%).



About 73% of respondents said their institutions have no plans to collaborate with a fintech firm on making consumer loans. However, the rest of the respondents said their institutions were already collaborating with a fintech company or were considering the collaboration for consumer lending.

Mergers and Acquisitions

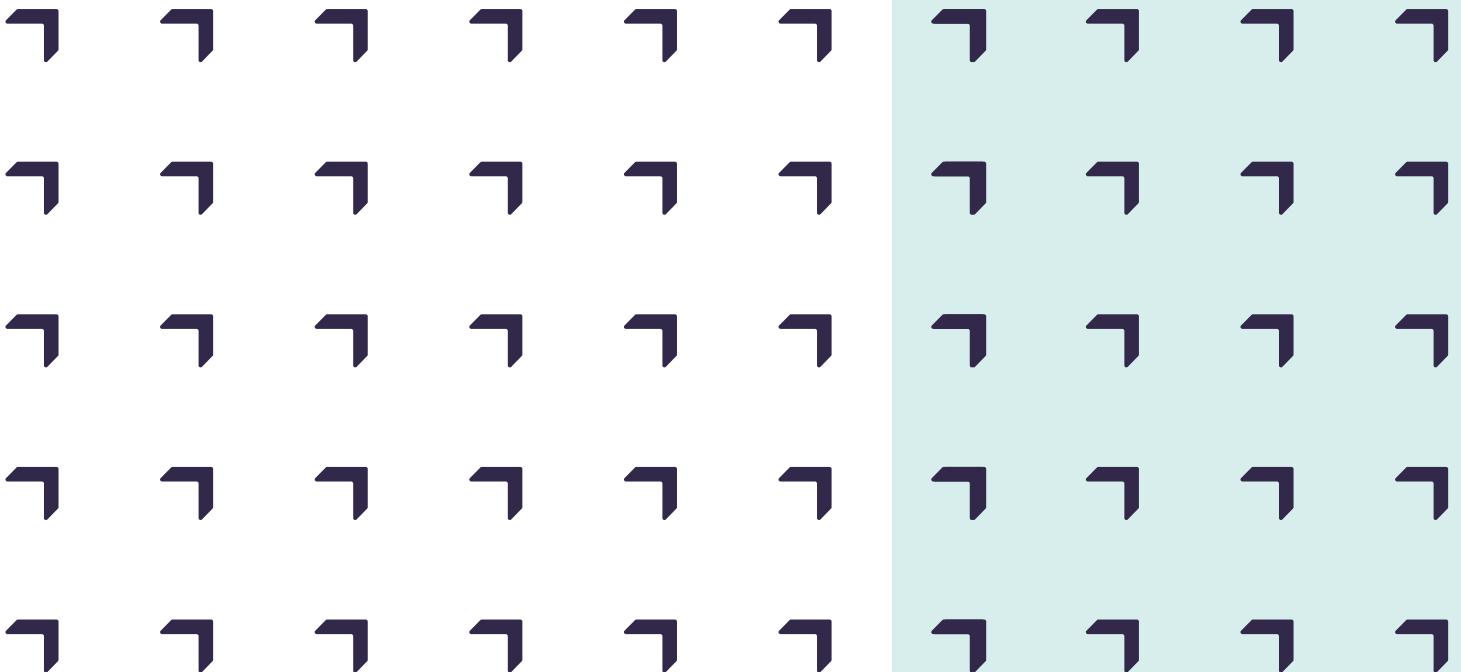
As the competition among banks and nonbank lenders grows, more community bank leaders are seeking ways to expand into new markets for future growth and to increase value to stakeholders.

About 32.8% of the respondents told us their organizations are planning to acquire or merge with another institution. Also, about 17% said that their institutions are likely to be acquired as an M&A target or enter into a merger agreement in the next two years. The rest of the respondents said their institutions are not planning for any M&A activities in the near future.

The next few years are going to force community banks to apply more strategic thinking about what the next initiative is.

“If new technologies or systems are involved, think through what risk assessments are related to that, and what vendors you are bringing in related to those products”

.....
Kevin Bastuga



Chapter 6: Staffing

Not surprisingly, before the pandemic, staff were primarily in the office with limited ability to work remotely. 61% of respondents said they were 100% in the office with limited ability to work remotely before 2020, while 38% responded that they were 100% in the office but with some ability to work remotely.

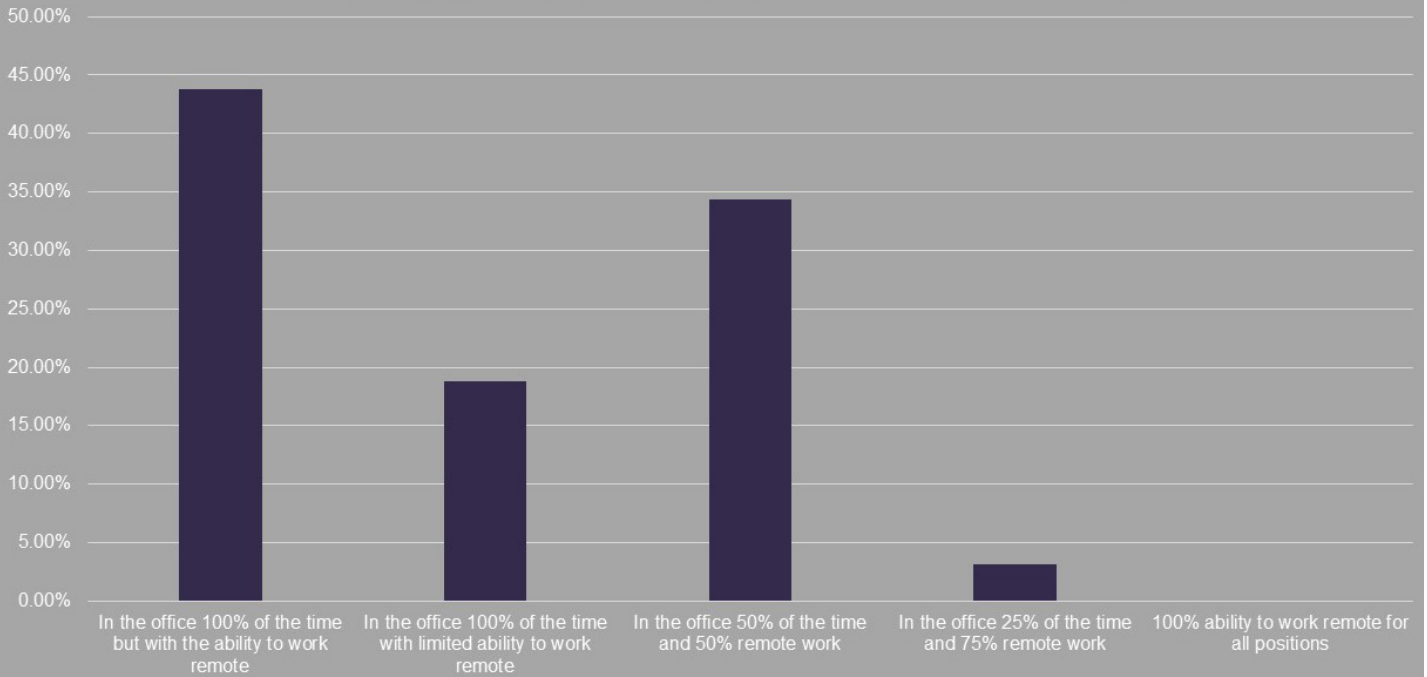
During the pandemic, less than 8% of respondents said they were 100% in the office with limited ability to work remotely. About 14% were 100% in the office but with some ability to work remotely.

But as the pandemic eases, remote working will be a more viable option for community banks. No participants expect all positions to be 100% remote but respondents show a variety of options for the workforce:

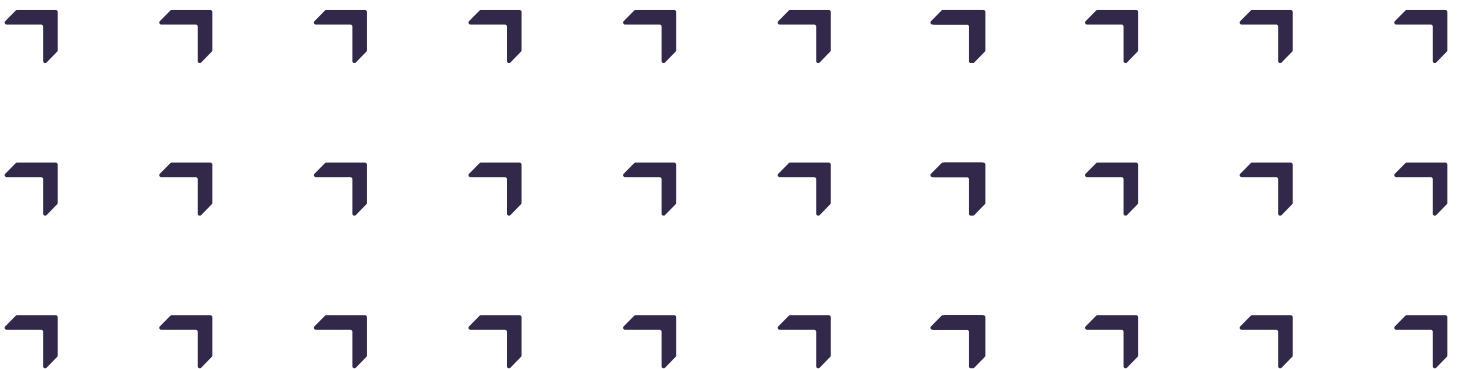
- 42% expect to be 100% in the office with the ability to work remotely
- 34% expect 50% in the office and 50% remote work
- 20% expect to be 100% in the office with a limited ability to work remotely
- 3% expect to be in the office 25% of the time and remote 75%

No participants expect all positions to be fully remote in the post-pandemic world, but the survey shows that they can still offer a variety of options for the workforce.

Post pandemic, how would you expect to define your staffing?



Answered: 64 Skipped: 1



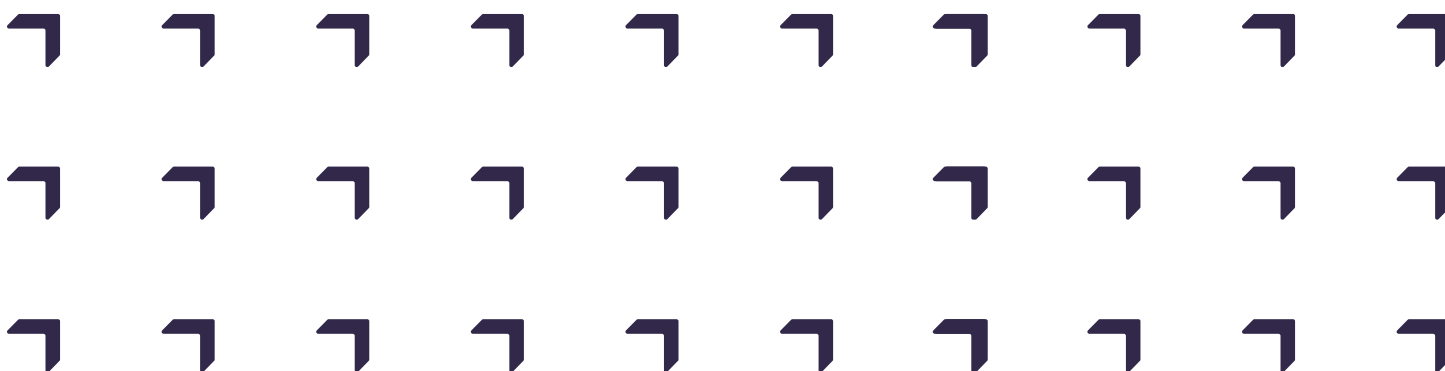


APPENDIX A - METHODOLOGY

From July to August 2021, RMA surveyed community bankers across the United States to identify the trends and issues in risk management affecting community banks. Community bankers whose institutions have assets under \$5 billion were invited to respond to the online survey. The survey collected responses from RMA members. The responses identified trends and issues critical to community bankers and their organizations.

The questions that RMA's Community Bank Council developed focused on the following areas:

- Critical risk management factors
- Regulation and compliance
- Issues when implementing new industry standards
- Lending service and product focus
- Innovation and fintech collaborations
- Staffing



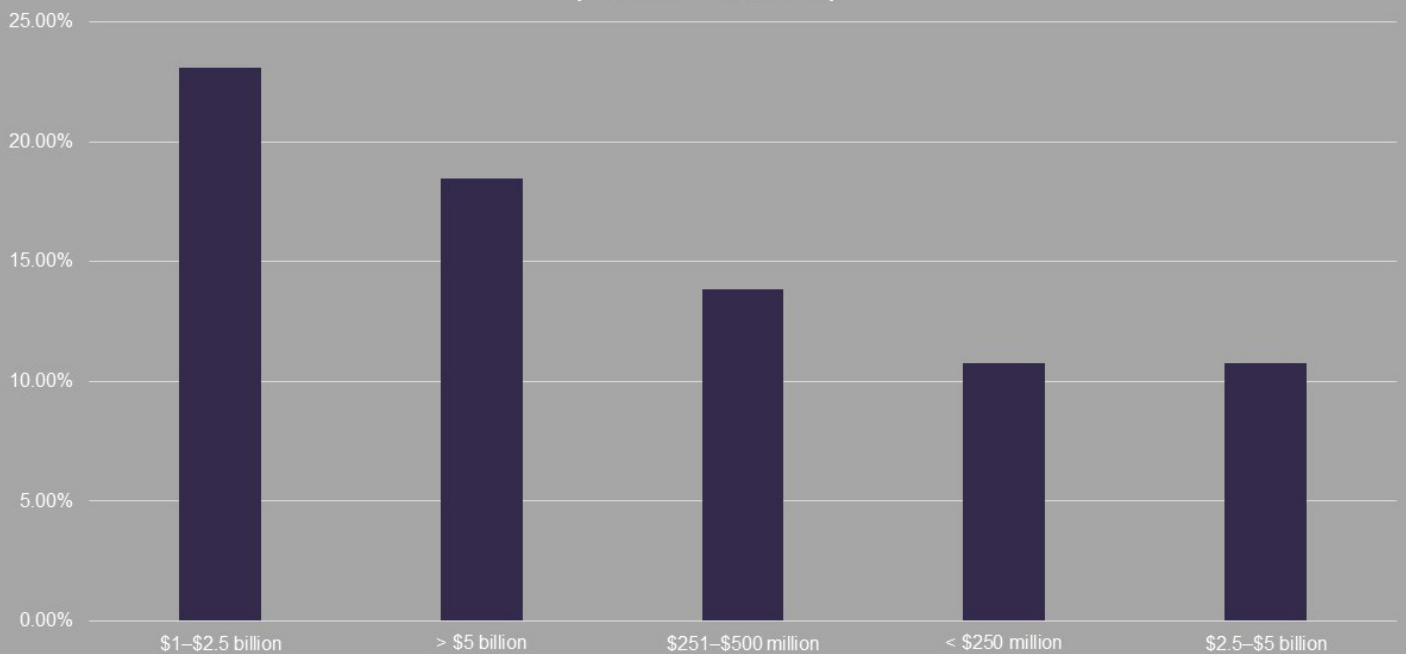


APPENDIX B - SURVEY DETAILS

Demographic information

65 participants responded to the 2021 survey. The following figure shows the asset size distribution of participants.

What were your institution's assets as of December 31, 2020?
(Please select one)



Answered: 65 Skipped: 0



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