Meeting the challenges: Community bankers' views

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Indeed, smaller [community] banks have repeatedly demonstrated their ability to survive and prosper in the face of major technological and structural change by providing traditional banking services to their customers.[1]

Events in the 1980s and 1990s have brought many changes to banking, and it looks as if the pace of change will only increase as interstate banking becomes a reality, nonbank competition continues to increase, and the diversity and complexity of financial products continue to expand. Today's community banks have survived the economic turmoil of the 1980s—one of the greatest challenges these banks have faced in many years. Part of their success has come from knowing their customers, providing personal service, and being leaders in serving the financial needs of their communities. Well-managed community banks are a vital force in their communities.

However, dramatic changes are now occurring in financial markets—changes that may go beyond the historical trends and patterns in banking and the economy that have been part of the community banker's experience. These changes include rapid technological development, substantial increases in computer usage and processing power, greater availability of information, and new financial products. For community bankers, these innovations provide opportunities to cut operating costs and bring a wider variety of services to their customers. At the same time, though, many of the changes are creating new competitors for community banks and giving their customers access to services outside of the local market. These changes are also complicating bank regulation. As financial products become more complex, regulations that cover these new products also become more complex.

How will community banks respond to these opportunities and challenges? Do community banks have the flexibility to cope with this changing environment? To find out, a survey was mailed to bankers in the Tenth Federal Reserve District[2] during December 1993. To be included in the survey, banks had to have less than $150 million in assets and not be part of a banking organization or chain that had total assets of more than $150 million. Out of the 1,834 banks in the Tenth District, 1,224 banks met these qualifications. A total of 676 usable responses were received, yielding a response rate of over 50 percent. A profile of the banks responding to the survey can be found in the accompanying Box.

THE SURVEY

The survey centered around four topics which touch on the major challenges facing community bankers today: competition from banks and nonbanks, changes in community bank operations, ownership and human resource concerns; and the impact of bank regulation. Bankers were also asked to identify the issues they expect to be the most important to community banking during the next five years, and were given the opportunity to comment on all aspects of the survey. Community bankers' responses and comments on these topics are discussed below.[3]

[1] *Alan Greenspan. "Optimal Bank Supervision in a Changing World." keynote address to the 30th Annual Conference on Bank Structure and Competition, Chicago, Illinois. May 12, 1994.*

[2] *The Tenth Federal Reserve District covers Kansas, Oklahoma, Nebraska, Wyoming, Colorado, and parts of Missouri and New Mexico.*

[3] *A copy of the complete survey results can be obtained by contacting the Public Affairs Department of the Federal Reserve Bank of Kansas City.*

Box: Who Responded?

The bankers that responded to the survey are the decision makers at their institutions. Over 79 percent are CEOs of their banks and over 90 percent are directors. Generally, they have considerable banking experience, but 17 percent report less than five years experience.

The banks represented in these responses are primarily small, independent, family-owned community banks. Generally, these banks have less than $50 million in assets (73 percent), no branches (65 percent), and are either independent banks or members of one-bank holding companies that are not affiliated with chain banking organizations (86 percent). Most of the banks are family-owned (63 percent), with a majority of their shareholders residing in the bank's community (74 percent).

The responding banks are generally in sound financial condition. Only six percent of survey respondents reported a 1992 return on average assets ("ROAA") of less than .5 percent, while almost one-fourth of the respondents reported an ROAA of more than 1.5 percent. These returns compare favorably to the ROAAs reported for all District banks with assets of less than $150 million. In addition, the survey respondents are better capitalized than all small banks in the District. Over 40 percent of the sample reported a year-end 1992 leverage ratio above 10 percent, compared to less than one-third of all District small banks.

The communities served by the banks in the survey are predominantly small, rural communities. Most are located in towns of less than 10,000 (76 percent) with economies primarily focused on agriculture (63 percent). On the whole, bankers included in the survey are optimistic about the economic prospects for their communities. Approximately half say their community has grown since the 1990 census, and most feel the economic prospects for their communities over the next five years are good to excellent (62 percent).

Competition

Community banks remain the dominant, and in many cases the only, financial institution in their own communities. Among the respondents to this survey, approximately 60 percent of the banks have no local competitors in either the loan or deposit market. This gives community banks a definite competitive advantage over other financial institutions that rely on mailings and toll-free telephone numbers instead of local facilities to communicate with customers.

But do community banks feel that their competitive advantages can be maintained, or are they concerned that these advantages may be eroding? The survey asked bankers what level of competition they expect over the next five years in both their loan and deposit markets. Bankers' responses to these questions shed light on how they expect their competitive environment to change over the next five years.

Loan market. A majority of the banks responding to the survey are located in small towns with agricultural-based economies and economic prospects rated at least "Good" (see Box). Improvements in the agricultural economy since the mid-1980s have increased lending opportunities for these banks. At the same time, downturns in other sectors have made agricultural lending more attractive to both larger banking organizations and nonbank lenders. Additionally, consumers in rural markets now have more options for meeting their credit needs. Credit cards can now be used to finance anything from groceries to major purchases, mortgage companies promise quick decisions and competitive rates, and credit union membership is open to just about everyone. In light of these trends, what changes do community bankers foresee in the credit market?

The community banks responding to this survey expect to face strong credit competition from both nonbanks and banks over the next five years. Almost half expect intense or very intense competition from lending subsidiaries of machinery and auto dealers (Table 1). These types of lenders may be different from other financial service providers because their credit programs are sometimes designed with the objective of increasing sales as well as providing credit services. This dual objective is often reflected in their loan pricing, making lending subsidiaries a tough competitor for commercial banks.

Table 1

Expected intensity of competition in the loan market 1994-1998

Competitor	Intense or very intense competitor	Moderate competitor	Weak or very weak competitor
Lending subsidiaries of machinery and auto dealers	**45.9%**	33.9%	11.6%
Other community banks	**43.9%**	44.7%	7.0%
Farm Credit associations	**39.1%**	31.1%	21.6%
National credit card marketers	**34.8%**	30.8%	22.5%
Banks or branches owned by in-state banking organizations	**34.7%**	35.4%	19.1%
Credit unions	**28.8%**	26.9%	32.8%
Banks or branches owned by out-of-state banking organizations	**24.0%**	23.4%	37.4%
Mortgage companies	**22.9%**	32.7%	31.7%
Thrifts	**11.4%**	34.0%	44.0%
Insurance companies	**11.1%**	30.3%	48.1%
Finance companies	**9.7%**	34.0%	44.0%

The next most frequently mentioned strong competitor is other community banks. More than 40 percent of the survey respondents say other community banks will be intense or very intense competitors in the credit market, even though less than 30 percent have another community bank located in their community. Survey respondents were less concerned about competition from larger in-state and out-of-state banking organizations.

The Farm Credit System is expected to be the third strongest credit competitor. Nearly 40 percent of the respondents anticipate that Farm Credit associations[4] will be intense or very intense competitors. This may be the result of the Farm Credit System's efforts to regain the share of the agricultural loan market that it lost in the late 1980s after its near bankruptcy.

A close fourth in the list of strong competitors is national credit card marketers. Nearly 35 percent of survey respondents foresee national credit card marketers as intense or very intense competitors.

Although not considered one of the strongest competitors overall, credit unions generate concern from a segment of the community bankers surveyed. Approximately 30 percent expect credit unions to be intense or very intense competitors, but almost the same percentage indicate credit unions will be weak or

[4] *Associations that are part of the Farm Credit System include Federal Land Banks, Production Credit Associations, Farm Credit Banks, Bank for Cooperatives, Federal Land Bank Associations, Federal Land Credit Associations, and Agricultural Credit Associations.*

very weak competitors. Upon closer inspection, the level of concern is closely associated with whether or not respondents have a credit union located in their community. If they do, respondents were twice as likely to expect credit unions to be intense or very intense competitors over the next five years. The depth of concern was evident in some of the written comments. One banker wrote:

> *Credit unions are taking a larger market share and are not playing on the same terms as we are. We have customers that tell us, "We will go to our credit union because we do not have to do as much paperwork and they will take us no matter what."*

Competitors most bankers say will be least important over the next five years include insurance companies, thrifts, finance companies, and mortgage companies. However, some community bankers expect intense competition from these financial service providers.

From these responses it is evident that community banks expect intense or very intense competition in the loan market over the next five years. Community bankers view specialized credit providers such as lending subsidiaries and the Farm Credit System as strong competitors. Yet, one of the stiffest competitors community banks expect to face in the near future is other community banks.

Deposit market. Depositors have become more aware of alternative savings and investment products. More and more of consumers' long-term savings can be found in 401(k) plans, IRAs, or company retirement plans, and correspondingly less in time and savings deposits. Although some banks are active in managing these savings plans, most are under the management of nonbank firms. In addition, mutual funds and brokers now offer a diverse array of products with tantalizing returns, albeit without deposit insurance.

How will these alternative products impact the competition for consumer deposits?

Community banks expect their major deposit market competitors over the next five years to be mutual funds and brokerage firms. A majority of the respondents expect the level of competition from these two nonbank competitors to be intense or very intense (Table 2). Additionally, almost half perceive the competition from other community banks and banks or branches owned by in-state banking organizations to be intense or very intense. Fewer community banks expect intense or very intense competition from branches or banks owned by out-of-state banking organizations, or from insurance companies, credit unions, or thrifts.

Many written comments voice the opinion that well-run community banks can compete successfully with larger in-state or out-of-state banking organizations, but emphasize concern about competition from other financial institutions that are able to offer different investment products. As one respondent wrote:

> *My bank needs to have the products available that my competitors have. Keeping restrictions on my bank while my nonbank competitors look like a bank, act like a bank, and sound like a bank is making it tough to compete . . . I can compete—but not with one hand tied behind my back.*

These results indicate that community banks anticipate strong competition over the next five years in both the loan market and the deposit market. The community bankers responding to this survey are most concerned about their ability to sell the financial products their customers are purchasing from nonbank competitors. This same concern is evident in their responses reported in the following section on which activities will make a larger contribution to bank operations in the future.

Community bank operations

Will community banks continue to look for traditional lending opportunities and fund these loans with core deposits, or are they considering emphasizing new lines of business and funding sources? New alliances are beginning to appear that are making it easier for community banks to offer new products to their customers. For example, the American Bankers Association recently began offering a program that allows community banks to team up with a broker/dealer to offer mutual funds and other investments that are nontraditional for banks. Also, community banks have found that teaming up with debit and credit card processors can allow smaller banks to offer services which were previously only cost-effective for larger banks. Arrangements such as these will allow more community banks to offer the diverse set of financial products that consumers are currently finding at larger banking organizations and nonbanks.

But are community banks considering expanding their activities in these areas? How are they planning to obtain the funds necessary to offer additional products or services? Are the support services community banks need both available and affordable? Additionally, are they evaluating the risk that comes with investing in these various opportunities? The following sections investigate what revenue sources community bankers see contributing to their operations over the next five years, how they expect to fund their activities, and how they plan to monitor and control the risk in their bank's portfolio.

Table 2

Expected intensity of competition in the deposit market 1994-1998

Competitor	Intense or very intense competitor	Moderate competitor	Weak or very weak competitor
Mutual funds	**64.9%**	17.8%	9.6%
Brokerage firms	**55.0%**	23.5%	13.9%
Other community banks	**47.5%**	42.3%	5.5%
Banks or branches owned by in-state banking organizations	**45.0%**	31.2%	12.7%
Insurance companies	**39.4%**	27.4%	23.8%
Credit unions	**32.1%**	32.2%	24.7%
Banks or branches owned by out-of-state banking organizations	**30.0%**	25.3%	28.8%
Thrifts	**27.3%**	39.9%	23.1%

Revenue sources. Community banks have generally focused their operations on meeting the credit and investment needs of the people in their communities. Consequently, their loan portfolios have traditionally emphasized credits for agriculture and main street businesses, credits for home mortgages, and credits for automobiles and other consumer purchases. Community banks have generally been able to fund these loans with deposits from the community. However, because of the increasing competition in the loan and deposit markets, the survey explored if and how community bankers anticipate changing their operations.

Survey responses demonstrate that community bankers intend to continue to emphasize their traditional lending and investment activities over the next five

years. Almost 60 percent of the respondents indicate that service charges and other fee income will make an increasing contribution to bank operations (Chart 1). Community bankers also expect an increasing contribution from all types of lending over the next five years. Fewer bankers expect an increasing contribution from investments in government securities (16 percent) or state, county, and municipal securities (23 percent). These responses indicate that community banks plan to continue to emphasize lending, despite the competition noted earlier, and that the volume of securities will not change materially.

Even though these results suggest that community banks plan to remain active in traditional bank activities, certain expanded activities are of particular interest. The activities generating the most interest involve expansion of investment product offerings for consumers. Few of the community banks surveyed have ventured into mutual funds, securities brokerage, or annuities, but most of those that have done so plan to expand their activities over the next five years. A significant portion (approximately 20 percent) of the banks not currently offering these investment services also expects to expand operations into these areas. Therefore, there appears to be increasing interest in expanding product offerings.

Additional activities that also appear to be candidates for expansion are: providing ATM services on bank premises, participating in regional or national ATM networks, offering adjustable rate mortgages, and selling participations in larger loans. Between one-fourth to one-third of the banks surveyed are currently engaged in these activities. Of these banks, 40 to 50 percent indicate they expect these activities to make an increasing contribution to bank operations. Among banks not currently offering these services, 20 to 30 percent indicate they expect these services to make an increasing contribution to bank operations.

Several services are viewed as making an increased contribution to bank operations by those currently offering the service, but are not seen as significant opportunities by banks not currently offering the service. Between 40 to 50 percent of the banks currently offering trust services, leasing, insurance (other than credit insurance), and data processing expect these services to make an increasing contribution to bank operations. However, less than ten percent of the survey respondents are currently offering these services.

The survey also explored bankers' interest in activities that are currently restricted for banks, such as holding debt and equity securities, securities underwriting, insurance brokerage and underwriting, and real estate development and investment. Nearly half the respondents say that these activities, if current restrictions were removed, would not significantly contribute to profits. However, about one-fourth of the bankers indicate that these activities would attract customers. The activity with the most potential is insurance brokerage; 35 percent of the respondents expect that this activity would make a moderate to large contribution to profits if restrictions were removed.

Funding Sources. Bankers' responses to this survey show that competition for customer deposits is stiff. Community bankers must find ways to fund their activities in a world where many different institutions are selling a variety of competing financial products. This survey explored how 12 different funding sources are expected to contribute to the funding base of community banks over the next five years.

The survey responses show that community bankers will continue to rely on traditional funding sources over the next five years. More than 30 percent of the respondents expect money market deposit accounts, NOW accounts, and certificates of deposit to represent an increasing part of their funding base (Chart 2). Savings

Chart 1

Expected Revenue Sources for Community Banks
1994 - 1998

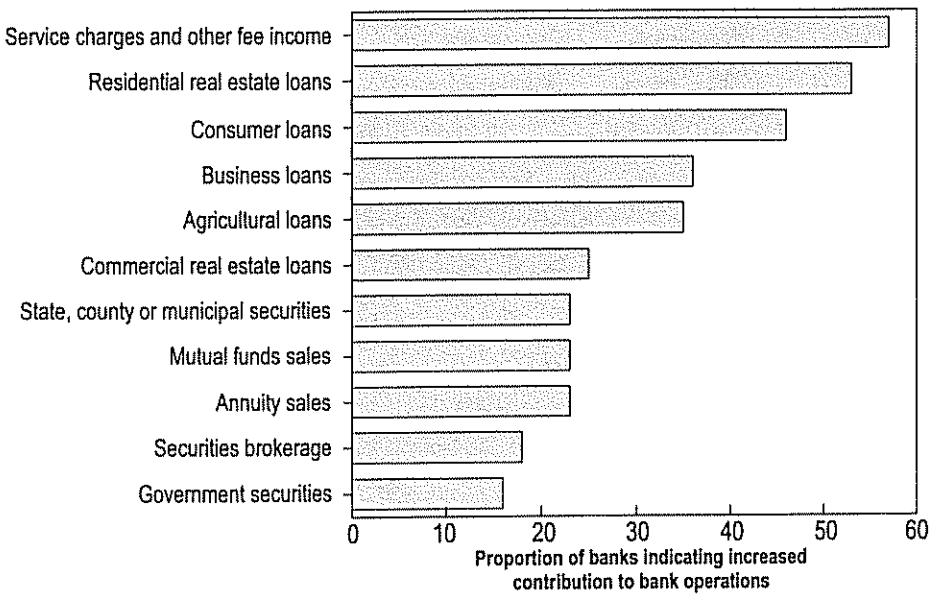
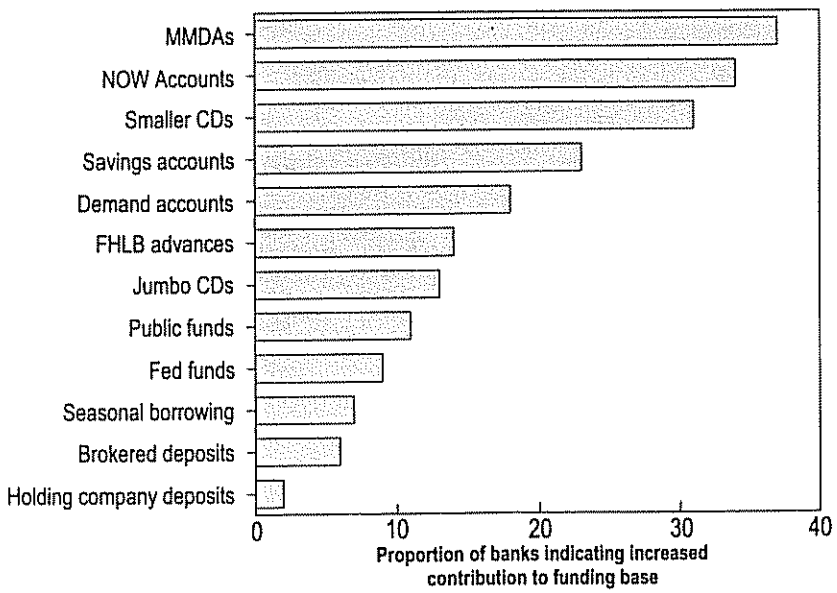


Chart 2

Expected Funding Sources for Community Banks
1994 - 1998



and demand deposits are also expected to increase. Fewer banks expect an increase in alternative sources such as Federal Home Loan Bank advances, large certificates of deposit, and brokered deposits.

Available services. For community banks to offer more complex banking services, they must have access themselves to appropriate support services. Accordingly, the survey investigated whether community banks have the support services they need to remain competitive.

The banks surveyed generally say necessary support services are both available and affordable, and many indicate that the services provided by others will be important to their ability to compete. Over three-fourths say services provided by correspondent banks and banking organizations are important or very important, while more than half respond that services provided by consultants, insurance companies, securities firms, and manufacturing representatives will not be very important to their ability to compete.

Risk control. Risk management is an increasingly important component of a bank's overall operations. Many of the new financial products have introduced different elements of risk into the bank - most noticeably, interest-rate risk. Because of the growing importance of this area, this survey investigated community bankers' opinions on three risk-related issues: risk-control strategies, methods of risk monitoring, and plans for maintaining adequate capital ratios.

To control risk, community bankers plan to rely on a combination of strategies. The bankers surveyed identify improved loan administration and policies and increasing management expertise and board oversight as the most important risk-control strategies to be used over the next five years. Internal and external audits, loan guarantees, industry diversification, and securitization are also identified by a majority of the respondents as important. One risk-control strategy a majority of community banks view as less important or not important is monitoring upstream correspondents.

Another aspect of risk is a bank's exposure to changes in interest rates. A full 98 percent of the bankers responding to this survey plan to monitor the interest-rate risk inherent in their portfolio. To do this, most plan to rely on management review, but 68 percent also plan to use one or more statistical measures. The most common statistical measure named is gap analysis (picked by 60 percent of survey respondents), followed by duration analysis (24 percent), and simulation analysis (19 percent). These figures demonstrate that many banks plan to use a combination of statistical measures and management review, and, in addition, show that many community bankers plan to incorporate sophisticated statistical measures in their monitoring of interest-rate risk. From these responses, it is evident that community banks recognize the need to monitor interest-rate risk.

Another part of an overall risk strategy is maintaining capital at a level sufficient to cover the risks inherent in a bank's operations. The survey therefore asked community bankers about their plans for maintaining adequate capital. Over 90 percent responded that the primary strategy for maintaining adequate capital over the next five years will be retaining earnings. Limiting growth is given secondary emphasis by approximately 40 percent of the survey respondents. Capital injections are rated as receiving little or no emphasis or unavailable by approximately 80 percent of the bankers surveyed. These responses indicate that outside capital for this group of banks is not a realistic expectation. Thus, for most community banks, maintaining adequate capital will depend on their ability to generate earnings.

Ownership and human resource needs

Dealing with the challenges that confront all community banks today requires more expertise from a bank's ownership, management, and staff than ever before. Thus, the outlook for community banks will depend, in part, on whether these banks and their communities offer the opportunities necessary to attract investors and qualified management personnel and staff. The following sections describe how community bankers plan to meet their ownership, management, and staffing needs over the next five years.

Ownership. Although some headlines suggest that community banks are on the way out, most of the community bankers in this survey expect no change in ownership over the next five years. But, this does not mean consolidation will not occur. Over the last five years, the number of banks in the Tenth District has declined by over 16 percent, and survey respondents indicate that this rate of consolidation is likely to continue. Fourteen percent of the community bankers responding to this survey expect to be acquired over the next five years (Chart 3). However, 40 percent of those that expect to be acquired (or 6 percent of all survey respondents), expect to be acquired by a community bank. In addition, 18 percent of the survey respondents expect to acquire other community banks, further supporting the view that community banks plan to be survivors. Notably, 65 percent of the respondents expect no change in their ownership structure over the next five years.

Management. Just as bankers see few changes in ownership in the near future, they also see few changes in management (Chart 4). Over half expect no change in management over the next five years. For those banks considering a change in management, promoting new management from within is more than twice as likely as hiring new management from outside the bank, and more than three times as likely as selling the bank and having new owners provide management. A larger percentage of banks below $25 million in assets (7 percent) indicate they are considering selling and having new owners provide management than banks above $25 million in assets (2 percent).

Although less than half of the community bankers expect a change in management, approximately 80 percent responded when asked to identify obstacles in meeting their bank's management needs over the next five years. These bankers identify the major obstacles as the location, size, and future prospects for their community; limited career opportunities at the bank; and inability to pay competitive salary and benefits. Although not a top choice, nearly one-third of the survey respondents identify lack of qualified personnel within the bank as an important or very important obstacle to meeting management needs. These results suggest that community banks may have difficulty attracting and retaining competent management.

The survey posed similar questions regarding the board of directors. Fifty-nine percent of the bankers surveyed say they will have problems attracting and retaining qualified outside directors over the next five years. The number one reason provided is director liability, followed by regulatory restrictions on loans to directors, and lack of qualified and interested people. All of these factors may be influenced by regulations that have been put in place or strengthened in recent years. As one banker wrote:

> *Community minded individuals who agree to serve on boards must go through a great deal of pain and agony to get accepted by regulators even though they hold no ownership. And to top it off, they can't even get a loan when they need one without jumping through more hoops than just another customer.*

Chart 3

Expected Ownership Changes for Community Banks
1994 - 1998

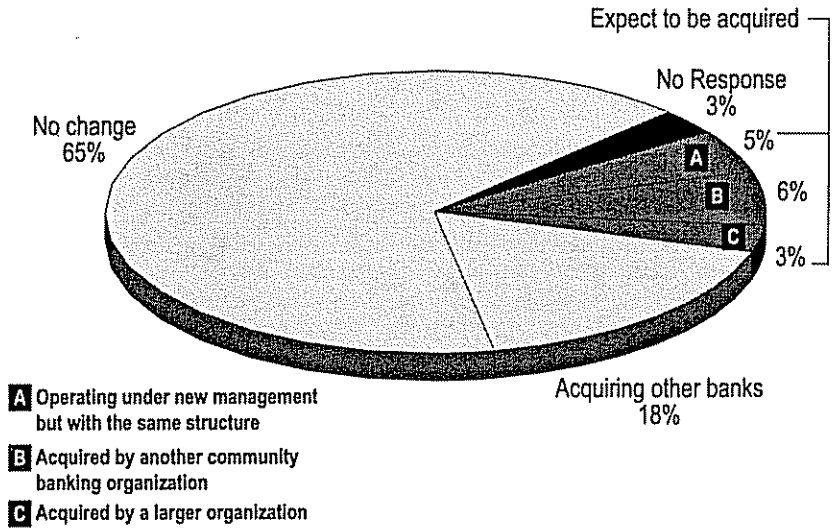
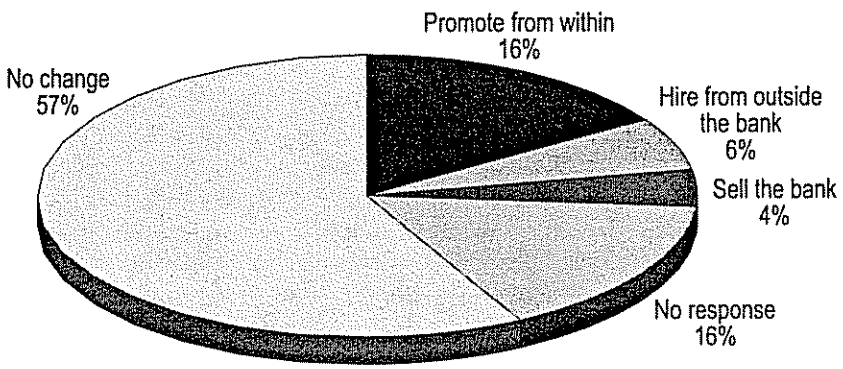


Chart 4

Expected Management Changes for Community Banks
1994 - 1998



Non-official staff. Attracting and retaining non-official staff is considered a problem by fewer respondents than attracting and retaining qualified management. Even so, nearly 20 percent say they will have problems attracting qualified staff. To combat this, nearly all of the bankers surveyed have programs in place to maintain and develop official and non-official staff.

Approximately half of the bankers indicate they plan to increase staffing levels over the next five years, while another 40 percent expect no change. The reasons given for increasing staff emphasize regulatory compliance (55 percent of survey respondents) and a growing market (51 percent of survey respondents). Only a small minority (11 percent) expect to reduce staffing levels. The most common reasons given for planned reductions in staffing are increased productivity of current staff and automation.

Impact of regulation

Much has been written about the regulatory burden facing the banking industry in general and community banks in particular. This survey did not attempt to measure the regulatory burden facing community banks. What it does measure is the changes community bankers anticipate making or have already made in their operations in response to regulation. Their responses shed light on how community banks are being affected by regulation.

The changes that the majority of community bankers surveyed *have already made* in response to regulation are: instituting external or internal audits (69 percent); adopting, improving, or giving increased attention to written policies and procedures (69 percent), instituting or improving a loan review program (63 percent), increasing the number and thoroughness of appraisals (55 percent), increasing contacts with community groups (51 percent), and increasing information collected on loan applications (51 percent). The changes almost half the bankers *anticipate making* or *would consider* are: changing the composition of their securities portfolio in response to moves towards market value accounting (46 percent) and adjusting their asset composition in response to risk-based capital guidelines (44 percent). Changes that a significant number of community bankers are *not* planning to make include: offering low-documentation loans (56 percent), increasing capital in response to prompt corrective action guidelines (53 percent), and offering lifeline accounts (45 percent).

Even though over 40 percent of the community bankers surveyed say they would not consider restricting deposits or eliminating loan products in response to regulation, over one-third did say they have already taken or are anticipating making such changes, and the rest say they would consider such changes. Among banks below $25 million in assets, an even greater percentage indicate they have already restricted deposits or eliminated certain loan products. Several respondents specifically identify home improvement and residential real estate loans as the most likely loans products to be dropped. One banker wrote:

> *In our own case, we do not engage in certain types of loans; most notably residential real estate ownership and home improvement loans due to the senseless forms and time consuming procedures . . .*

Although community banks may not intentionally limit their loan and/or deposit offerings, several written comments raise the possibility that time spent on documentation and procedures means less time available to generate business. For example, one banker wrote:

> *. . . we spend most of our time with written policies and not with our loan portfolios.*

Community banks are making changes in their operations to adapt to the current regulatory environment. Responses suggest that community bankers are making a concerted effort to ensure lending services are available to all income groups. Community bankers are paying increased attention to the fine points of lending, with emphasis on loan review, appraisals, and collection of loan applicant information. Additionally, community bankers are increasing their usage of audits and more formalized policies and procedures. However, some banks may realign their asset portfolios and securities portfolios, and may consider limiting certain deposit offerings and eliminating certain loan products in response to regulation.

Future problems facing community banks

The final question on the survey asked bankers to identify those issues that will present the most problems for community banks over the next five years (Table 3). The top two issues identified by the respondents are increased regulation (76 percent) and competition from nonbank financial service providers (58 percent). Numerous written comments were provided by the survey respondents, which stress the high level of concern and frustration relating to these issues. These comments also amplify the responses discussed in the previous section.

A major complaint of community bankers is the volume and complexity of new regulations. The time required to read, understand, and implement new regulations is a significant cost, particularly to smaller institutions with less staff to absorb these tasks. A vast majority of written comments addressed this issue. One banker described the problem this way:

> *There is just too much paperwork coming out of Washington, D.C. I would guess that we get one inch of reading material each week. It is almost impossible to read this material, see customers, and oversee the operations of a small bank.*

The underlying concern that is evident in many of the written comments is how increased regulation affects bank profitability. One banker summarized the problem as follows:

> *I believe that the small community bank cannot have a decent ROA and hire the staff necessary to stay in compliance with all the existing and new regulations.*

Although many community bankers expressed concern about regulatory burden, written comments reveal how closely this concern is tied to expected competition from nonbank financial providers over the next five years. Many comments address the unequal regulatory treatment that currently exists among the various financial service providers, and how this impacts community banks' competitiveness. Two bankers wrote:

> *From our perspective, the loss of market share of the banking industry is directly related to the competitive disadvantages plaguing banks due to overregulation. The extra overhead resulting from increased personnel costs, EDP equipment and software costs, legal and consulting costs, and training costs has significantly impaired our ability to offer deposit products at rates offered by nonbank producers as well as loans at rates offered by nonbank institutions . . . Help us compete evenly and fairly and we will see the disintermediation and loss of market share reverse.*

> *Banks have become the high-cost provider of financial services due to the costs of regulation. Other providers of financial services do not have the regulatory burden which banks have.*

Many bankers distinguished between safety and soundness regulations and compliance regulations. Compliance regulations, such as the Community Reinvestment Act ("CRA"), the Real Estate Settlement and Procedures Act, and Truth-in-Savings, generate the most frustration. The following comment is one example:

> *As a rule, small banks are doing a very good job of CRA, etc. or they would not be in business. The burden of compliance with all the written policies and attempting to make a small bank a clone of large money center banks is ridiculous. If there is a need in rural and small communities for community banks, they should be there. Their existence should depend on the need and support of their communities. Their nonexistence should not be forced on communities because of the tremendous burden of regulations and requirements which many times do not pertain to the actual service of banking, nor to the safety and soundness of the bank.*

Other respondents object to certain compliance regulations on the basis that they require banks to implement social goals. One banker wrote:

> *I don't see insurance companies selling insurance at discounted rates to low income people—I don't see stock brokers making contributions to charity.*

Some written comments even point out that many of the regulations that were enacted to protect consumers are viewed as nuisances by most consumers. Another banker wrote:

> *Interestingly, most consumers view these compliance efforts as "hassles" and impediments to doing business rather than personal consumer protection measures.*

One solution offered by several respondents is to relate the intensity of regulatory oversight to the size and activities of the banks. A tiered system of regulation would allow community banks to remain competitive by releasing them from the burden of complying with regulations that are not appropriate for their institution, yet would not compromise the safety and soundness of the banking system. One banker suggested the following:

> *There needs to be a two-tier system of regulation and compliance to exempt community banks from many of the burdens that are not relevant to safety and soundness of bank operations.*

Table 3

Significant problems expected for community banks 1994-1998

Issue	Response
Complying with increased regulation	75.7%
Competing with nonbank financial service providers	58.4%
Remaining competitive as a community bank	32.8%
Meeting competition from larger banking organizations	32.8%
Offering more complex banking services	27.4%
Maintaining deposit share	27.1%
Achieving a competitive net interest margin or return on average assets	25.6%

CONCLUSION

It is evident from the survey that community banks face significant challenges over the next five years. Intense competition from nonbanks and other community banks is expected in the loan market and the deposit market. Many community bankers indicate that the regulatory burden imposed on them seriously hampers their bank's ability to compete and ultimately to survive. The related issues of regulatory burden and nonbank competition are clearly the critical issues for these community bankers. Their concerns must receive careful consideration as banking laws and regulations are drafted and debated.

In the face of these challenges, community bankers generally see themselves sticking to the basics: emphasizing lending on the asset side and deposit-taking on the liability side. Most also intend to maintain their present ownership and management. Consolidation will continue, but at a pace similar to the consolidation that has taken place over the past five years. In fact, a significant percentage of community banks will be the acquirors rather than the targets. Two bankers' comments offer at least a partial explanation for the resiliency of community banks and the confidence that many have in their future:

> *Community banks can generally provide a higher level of customer service at a reasonable/competitive cost than many other financial service companies or banks.*

> *Community banks will always be in demand because banking remains a "people business" in which the customer wants attention, recognition, and service far more than he wants an extra few basis points in yield on deposits and a reduction in [the] interest rate charged on his loan.*