

DIRECTOR'S PERSPECTIVE ON THE ROAD TAKEN, THE ROAD AHEAD

Better keep your boardroom seatbelt on

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There has not been a more challenging time in my life than my time as a bank director.

And I'm afraid it may not get easier anytime soon.

No end of challenges

We all know the challenges that community banks have faced in the wake of the credit crisis and the ensuing global financial meltdown. Banks in distressed housing markets that had not already securitized their mortgage portfolio faced imminent challenges beginning in 2007. Some of these banks were able to restructure, while others were restructured by FDIC. Fortunately, most community banks with a balanced asset portfolio were able to weather the initial storm.

However, that early success in the face of financial adversity has not meant the end of challenges for community banks. While the liquidity challenge early in this recession has receded, directors now face myriad new clouds on the horizon.

The first emerging challenge comes from regulatory bodies that have been charged with ensuring we avoid further bank failures. The new regulatory zeal is well-intentioned, but has placed additional costs and burdens on prudent and well-managed community banks, so they don't repeat the fate of those banks that were not. Regulators are also imposing on the remaining good banks both compliance burdens and stress tests. Large universal banks were bailed out and their books then scrutinized, often quite publicly, and it is the well-run community bank that now faces a disproportionate level of scrutiny.

Directors have found it necessary to become fluent in an entirely new vocabulary, arising from the need to regularly stress-test our forward-looking cash flow projections. While this increased sophistication required of directors is certainly a great learning experience, the costs to our community banks and boards are significant. As always, though, our boards and banks are rising to the occasion. And we are becoming stronger for it.

Are you getting “BDB”?

This guest column comes from ABA Bank Directors Briefing, the monthly board newsletter published by the editors of ABA Banking Journal. For over 30 years, “BDB” has worked to inform and educate directors, and to promote constructive cooperation between professional bankers and their boards. For a sample of the current issue and an order form, [click here](#).

Good banks have found themselves flush with cash, with little good loan business coming through their door in the wake of a plunge in business investment and construction activity. In past times when there was a lull in lending, banks traditionally invested in medium-term bonds.

However, with 30-year treasuries yielding less than 3%, and 10-year treasuries at about 1.6%, the miniscule interest rate return seems little worth the capital loss risk that will be realized once interest rates rise. Directors observe and must respond to the challenge that the Federal Reserve's quantitative easing has produced on our banks in its unrelenting effort to keep interest rates down.

Public role as directors

Directors often hear from our communities that banks are not lending. Indeed, customers are surprised when we respond that our banks remain active in soliciting new loan business.

However, we must still perform the diligence our shareholders expect by lending only to those who are likely to repay. Until households begin building homes again, and until our local businesses see the economic climate as opportune for expansion, there is little a bank can do, even at these low prevailing interest rates.

Rather, we are now seeing sectors in our communities that have been holding on for longer than they have had to in any past recession. Some households and some businesses can hold on no longer. Contrary to what one might think four years into a dramatic economic slowdown, loan losses, while manageable, have not abated significantly. Directors continue to endorse the need to maintain healthy loan loss reserves in this era of economic uncertainty.

Avoiding gloomy mindset

Other uncertainties continue to cloud our horizon going into 2013. Constant threats about Fiscal Cliffs and such give businesses pause and delays their expansion.

Community banks see this hesitancy. Our boards remain hunkered down in the face of political uncertainty, but continue to refine the business model to seek other forms of fee-based income, perhaps through insurance brokerage or other offerings to our customers.

Regulatory uncertainty also looms large. ABA has kept us informed about challenges that have appeared, and which continue to appear, as Dodd-Frank legislation is converted into regulation. The regulation-writing process is fraught with uncertainties for the community banks. It appears that legislation motivated to constrain mega institutions ultimately impinges on the bottom line of the community banks that are part of the solution.

Still, cause for optimism

While directors at community banks have found this past year to be challenging, and imagine that next year can be even more so, there also remains some excitement in the air.

Our banks have been forced to become leaner and most efficient, and have embarked on new product lines and markets. If our politicians can create an atmosphere of more regulatory certainty and economic encouragement, there is a latent demand for private infrastructure improvement and investment. Our customers have become wary of the large banks that seem focused on international markets and on continuing legal problems. And, our communities have shifted their greatest confidence in all things local. The potential opportunities that may flow as economic challenges are overcome should bode well for our community banks.

Ultimately, directors of community banks are community members ourselves. We see our towns ready to sprout, and we want to play an important part in recovery-a recovery that will begin in our backyards.

It has been a difficult time for community banks and their directors, but those who weathered the economic storm have emerged stronger. When we can sprout is beyond our control. But, when a strong recovery begins, community banks are in a good position and anxious to help pave the way, as always.