Insights Into 2012

Community Banks Balance Growth, Efficiency and Compliance

Abound Resources shares results from its annual survey of community banks and provides its insights into winning strategies for 2012

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Executive Summary

Each year Abound Resources surveys senior executives at community banks across the U.S. about their priorities, plans and concerns for the upcoming year. Several of our findings were expected: for example, CEOs remain concerned about the weak economy and continue to view regulatory compliance and a weak economy as significant challenges. Also consistent with prior surveys, operational and technology efficiency remain high priorities.

Other survey results were surprising, and even worrisome. Even though non-interest income in banks under $3 billion in assets fell in 2011, CEOs are not pushing initiatives to grow fee income. In 2011, 59% of CEOs indicated growing fee income was a priority. In 2012, only 22% indicated it as a priority. There are ways for banks to recover this lost income, and we outline some of the most promising strategies.

For the past three years, our annual survey has revealed a technology disconnect. In 2012, CEOs tell us that their top three priorities are to grow commercial loans, improve efficiency and address regulatory requirements. Yet the top four planned technology purchases are mobile banking, tablets and iPads, consumer remote deposit capture and online account opening. None of those four will move the needle on the CEO's top priorities.

Additionally, just 40% of CEOs plan on buying new technology, but 75% of CFOs, COOs and CIOs have purchasing plans and 61% expect increases in technology spending over 2011.

The top growth priority for CEOs is expanding their commercial lending business, followed by improving market share in the small business market. This is an encouraging finding as we believe that focusing on small and mid-sized businesses can help banks replace lost fee income. However, we found very little interest in commercial cash management services, a natural compliment (and income source) to commercial lending.

There's a real juggling act occurring in community banks as executives struggle to balance their desire for growth with the need for efficiency to combat increased compliance costs. However, like quite a few CEOs in our survey, Abound Resources is optimistic that banks can meet these seemingly divergent requirements. The CEOs and C-suite executives we've had the pleasure to work and speak with display a real roll-up-your-sleeves attitude now that most of the regulatory uncertainty surrounding the Dodd-Frank Act and Durbin Amendment has lifted.

Yes, it's time to get back to work, and in a nod to that enthusiasm and sense that the worst is behind us, we've added the *Top 5 Community Bank Strategies for 2012* to our survey results to help you translate our findings into action.

Key Survey Highlights

- ✓ Forty-two percent (42%) of CEOs are optimistic about the coming year, a slight increase from 2011.
- ✓ CEO's top concerns are regulatory burdens (67%) trailed closely by the weak economy and loan demand (64%).
- ✓ CEO's top priorities are grow commercial loans (75%), improve efficiency (62%) and address regulatory requirements (55%).
- ✓ The top growth strategy for CEOs in 2012 is to grow commercial loans (75%), a significant percentage increase over 2011.
- ✓ Just 40% of CEOs plan on buying new technology, while 75% of CFOs, COOs and CIOs have purchasing plans and 61% expect increases in technology spending over 2011.
- ✓ The top priorities from COOs, CIOs and CFOs are buy/replace mobile banking (43%), improve utilization of Internet Banking (40%) and improve utilization of estatements (38%).
- ✓ The top purchasing projects for COOs, CIOs and CFOs are mobile banking (43%), tablets and iPads (32%), consumer remote deposit capture (29%) and online account opening (29%).

About the Survey

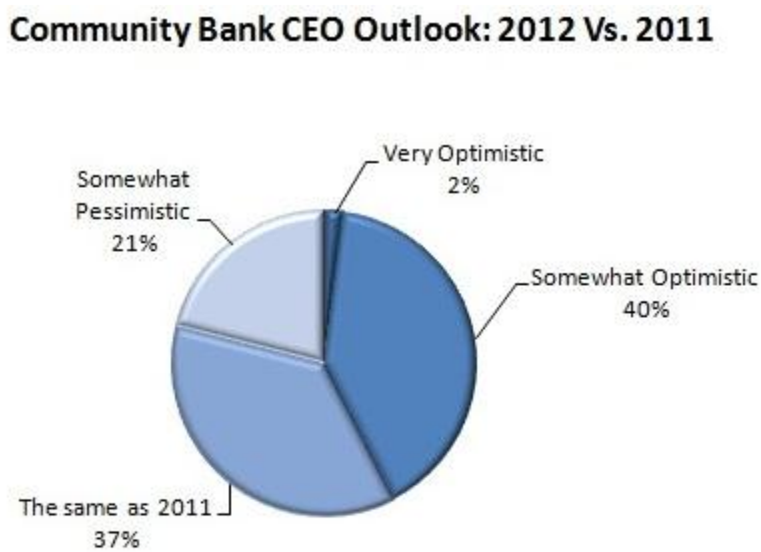
Abound Resources conducts an annual web-based survey of senior executives in community banks throughout the U.S. This year's survey, administered in December 2011, received 170 responses from Presidents/CEOs, COOs, CIOs and CFOs. Responses were distributed as follows:

Asset Size	Responses
Less than $100MM	10%
$100MM - $250MM	20%
$250MM-$500MM	35%
$500MM - $1BB	19%
More than $1BB	7%

The CEO Perspective:

The Worst is Behind Us

There's little doubt that it's still a difficult and challenging economic and business environment for community banks but, as in 2010 and 2011, bank CEOs remain a pretty optimistic bunch. Forty-two percent (42%) of CEOs said they were more optimistic going into 2012 than they were going into 2011.



In our conversations with community bank CEOs, these executives convey an overall sense that the worst is over. They feel that the economy will continue to stumble along but it won't slip back into recession. The Dodd-Frank Act and the Durbin Amendment are now law and although CEOs don't like the current regulatory environment they, as they have so many times before, are moving forward on dealing with the new regulatory reality. The regulatory environment may not be good—and in fact many CEOs express anger about it— but at least much of the anxiety and uncertainty about what will happen in D.C. has subsided. Of course, the fear remains that the new Director of the Consumer Financial Protection Bureau (CFPB) will change all of that.

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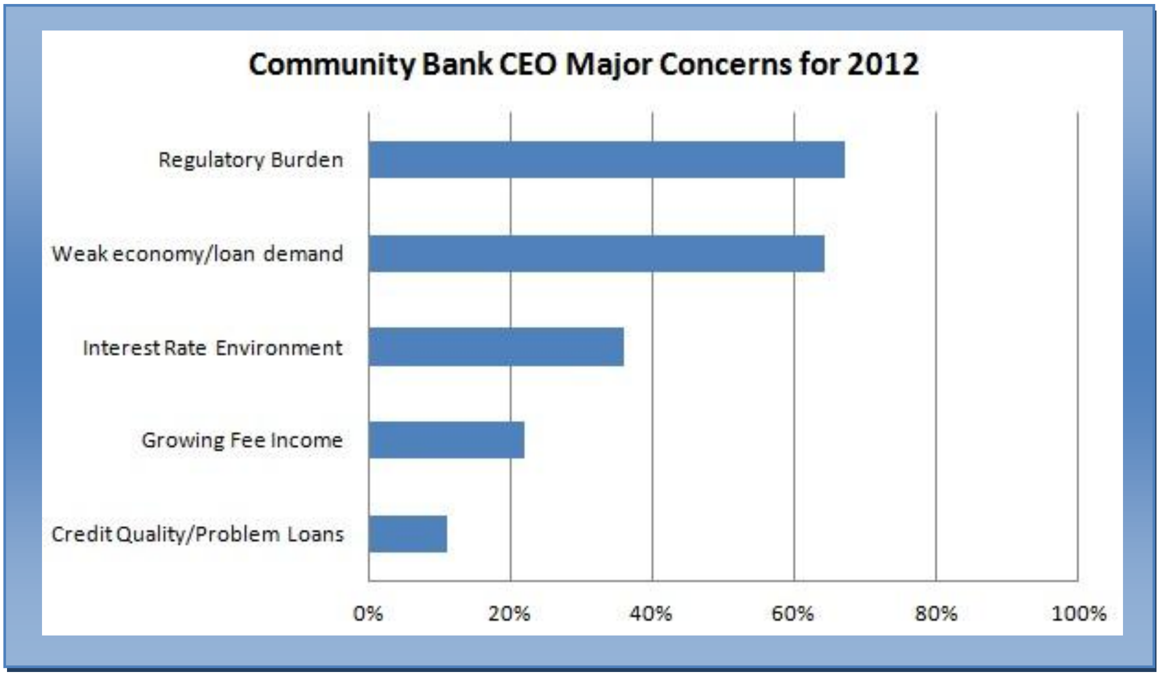
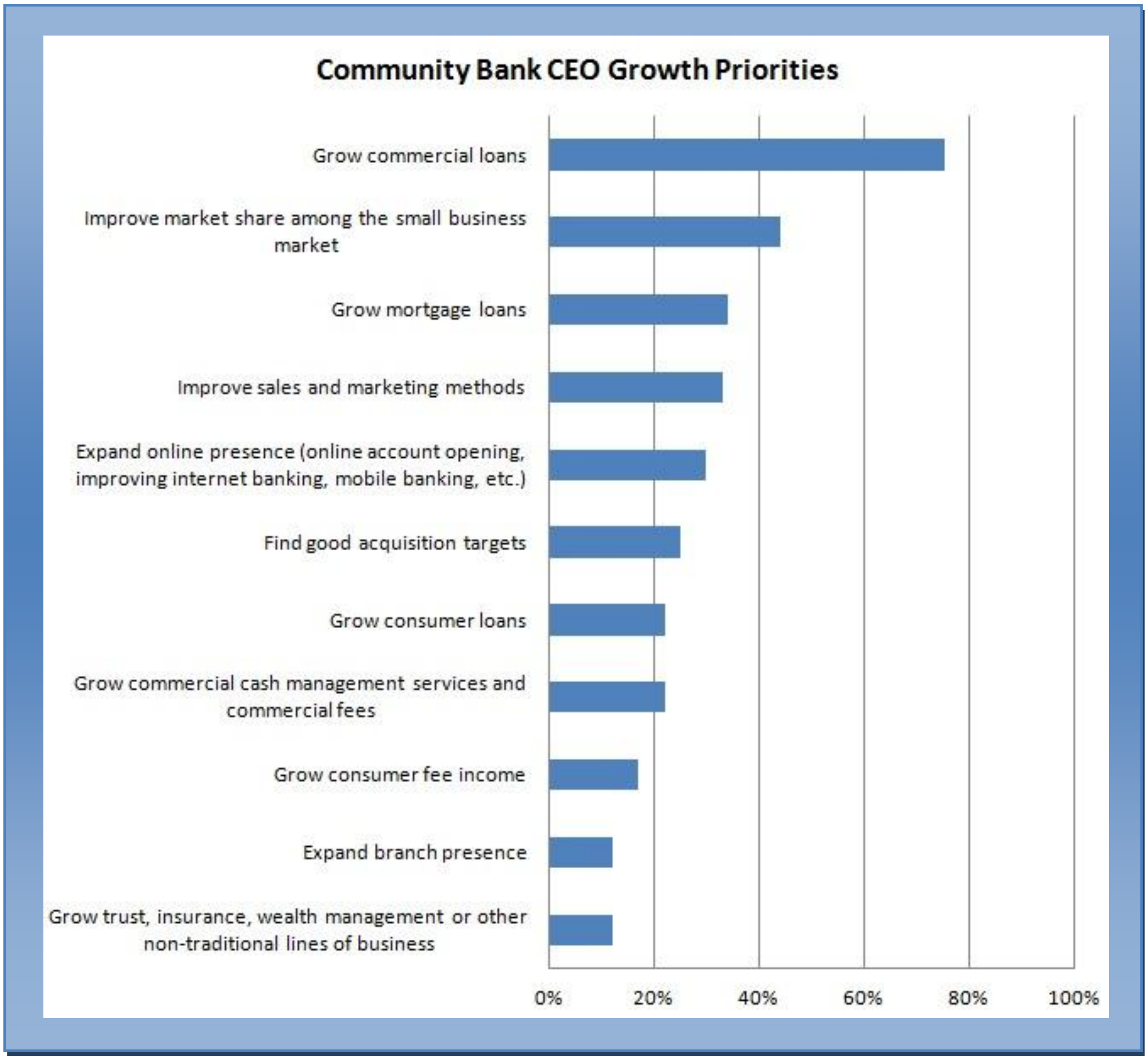
Macro Issues Cause Concern

We asked a new question in our 2012 survey: "What is your biggest concern?" We found that CEOs expressed the most trepidation about macro factors that are largely outside of their control, including regulatory burdens (67%), a weak economy and loan demand (65%), and the continued low interest rate environment (36%). Growing fee income (22%) and credit quality/problem loans (18%) - factors that the CEO can act upon and influence - were less of a concern.



Growth Priorities Evolve

The number one growth priority for bank CEOs in 2012 is growing commercial loans (75%). Although this was the number one priority in 2011 as well, there's a somewhat significant increase from 2011 (66%). In 2011, the survey indicated community banks were treading water and focused on cleaning up their loan portfolio. This year, they are ready and wiling to once again tap into the more lucrative commercial lending market rather than focusing on consumer loans. Another lending growth area is mortgage loans (39%); mortgage loan growth was number seven in 2011 and number six in 2010.



Improving small business market share was the number two priority. Abound's small business practice has observed three primary factors driving community bank's renewed interest in small business:

- The need to grow commercial fee income to offset drops in consumer fee income
- The desire to leverage the existing cash management product and delivery infrastructure
- A hedge against the impact of Reg Q when commercial deposit profitability will drop

Deepening penetration of the small business market can help offset the lost consumer fee income and should be part of the revenue replacement strategy for many community banks. Unlike the consumer market, where less than one third of accounts are profitable, nearly all small business accounts are profitable, with a typical account generating more than $1,000 in annual profit from balances and fees. In addition, community banks are perceived as being more flexible and accommodating to small businesses than the mega banks. It remains a great time to take advantage of the backlash against the big banks.

What's disconcerting is that even though growing commercial business is a high priority, less than a quarter (22%) state that growing their commercial cash management services and commercial fees is a priority. To meet examiner (and Board) requirements for a more diverse loan portfolio, many community banks are expanding their commercial and industrial (C&I) lending. Cash management services are a necessary compliment to C&I lending and those community banks not focusing on cash management are losing an opportunity for C&I growth and fee income.

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We had hoped that sales and marketing would be higher up on the CEO priority list since we believe that sales and marketing has much room for improvement, especially in the burgeoning area of online marketing and social networking. Perhaps banks are not yet ready to commit the investments and drive the cultural changes required to truly improve sales and marketing.

Expanding online presence (30%) dropped significantly in importance from 2011 when 46% named it as a growth priority. There may be some realization among CEOs that the track record for actually growing customers via online delivery channels remains cloudy at best. Community banks have been justifying improved online investments with, "We need to have an online presence to attract younger customers." But the number of new accounts actually opened online has been disappointing.

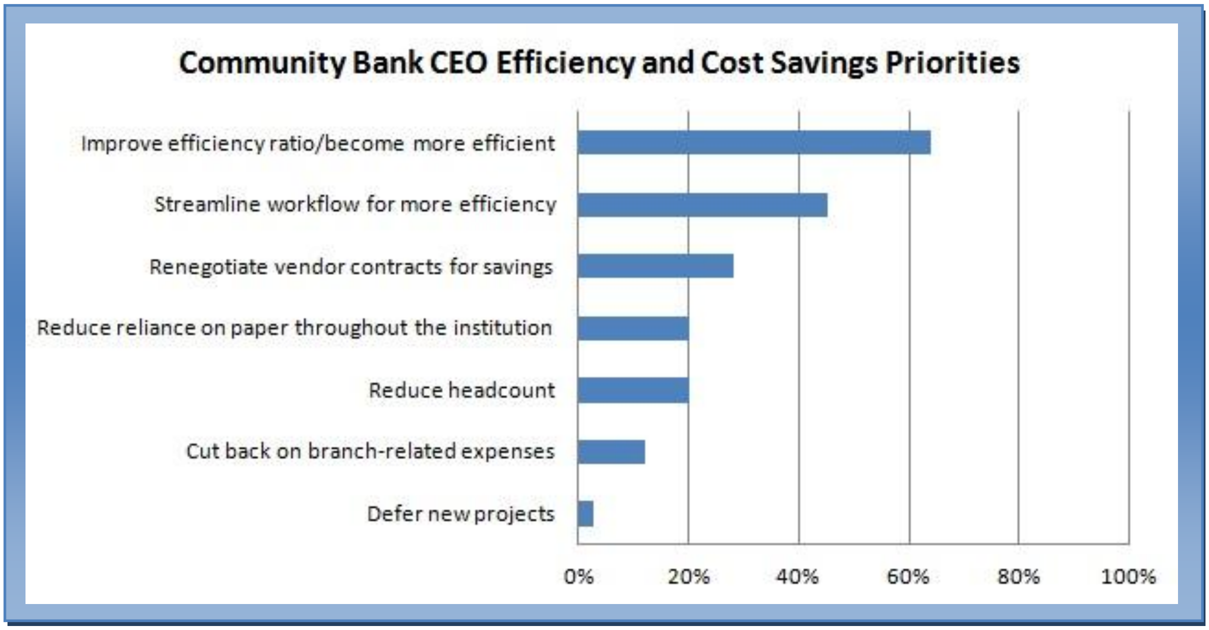
The most startling survey results surround the lack of urgency in growing fee income: Only 22% indicated commercial fee income and 17% indicated consumer fee income as priorities.

Fee income was a huge issue for community banks going into 2011 due to the potential interchange fee caps proposed by the Durbin Amendment. Although that legislation largely only impacts institutions with more than $10 billion in assets (at least in the near term), community banks remain incredibly dependent on fee income. We are very concerned that fee income is such a low priority. NSF/OD income continues to decline while compliance, personnel and technology costs continue to climb. And now that the Fed has indicated it will keep rates flat for the next year or two, we know that spreads are not going to change much. Where is the revenue going to come from?

We are very concerned that fee income is such a low priority. NSF/OD income continues to decline while compliance, personnel and technology costs continue to climb.

Chasing Efficiency

This year once again the top two efficiency and cost savings priorities are improving efficiency ratios/becoming more efficient (64%) and streamlining workflows (45%).



Renegotiating vendor contracts has become less important for CEOs since last year's survey. In 2011, 37% of CEOs named contract renegotiation as a priority compared to 28% in 2012. This decrease could be because banks believe they have already exhausted renegotiation as a cost savings strategy. However, our experience is that even banks that have asked for contract reductions from their vendors continue to overpay for technology. There's a lot of money still left on the table and renegotiation remains among the easiest cost savings since it doesn't impact customers or employees.

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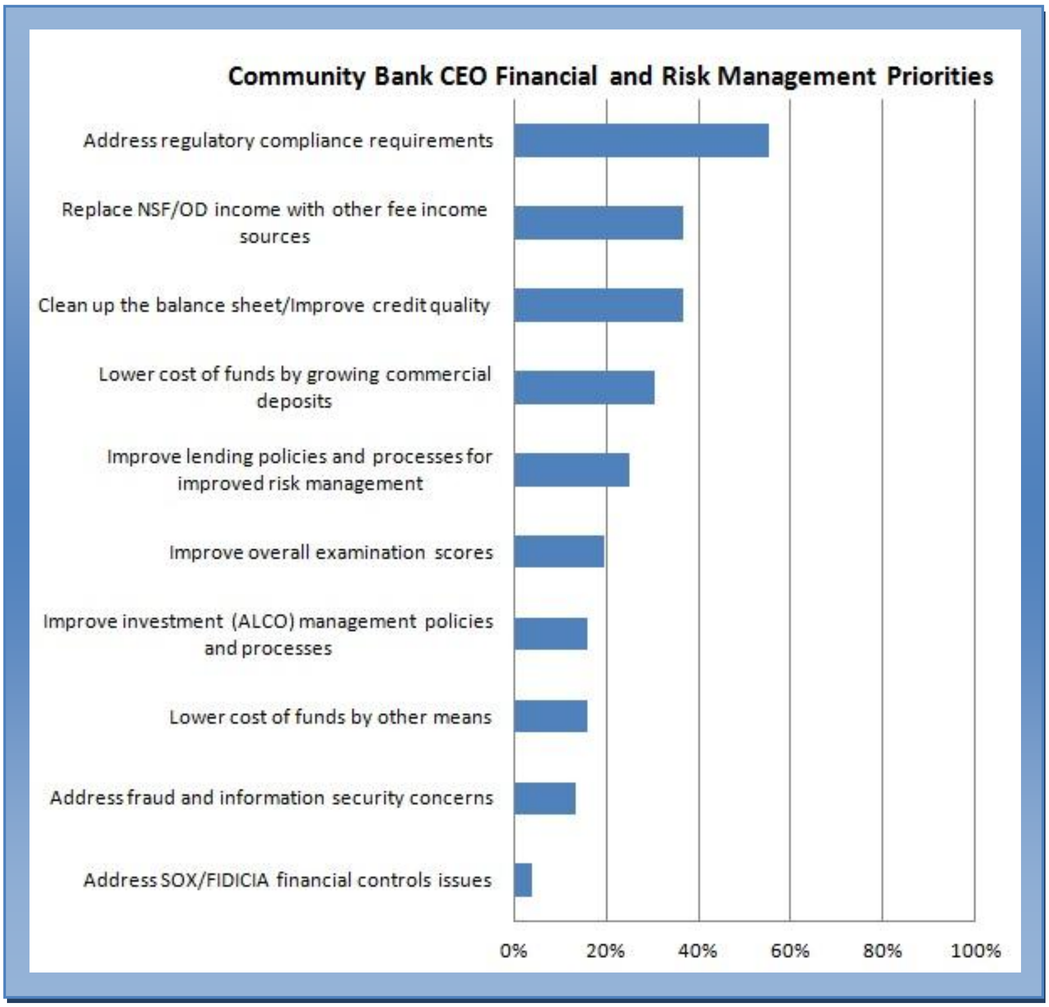
Compliance Trumps All

In today's regulatory environment, it's not surprising that addressing regulatory compliance requirements (55%) remains the most pressing financial and risk management CEO priority for 2012, dwarfing replacing NSF/OD fee income (37%). Replacing fee income was the second most cited priority in 2011 as well, but was much higher as a percentage of responses at 59% since last year at this time banks were still unsure about the impact of the Durbin Amendment.

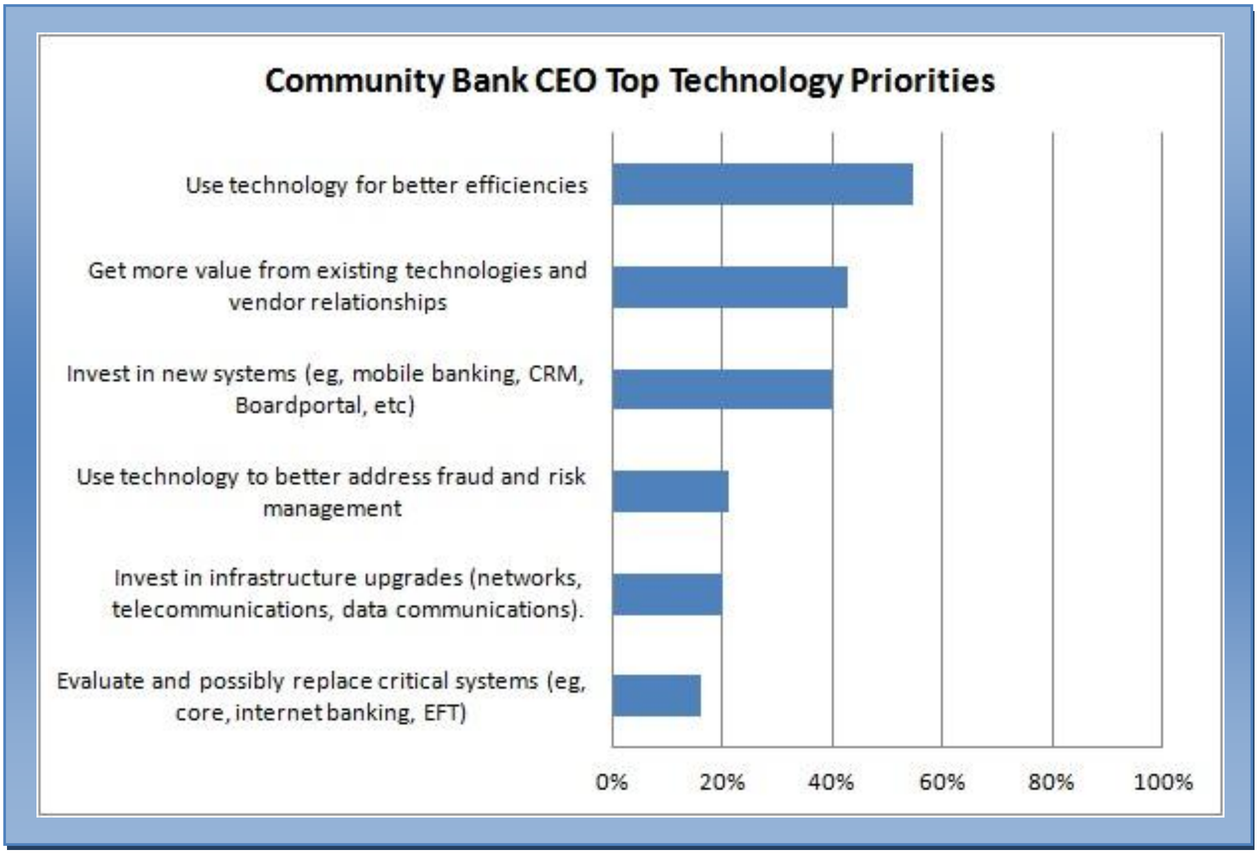


Not only are banks dealing with a huge number of new regulations, but many CEOs we've spoken with express concern that their relationships with their examiners—some of whom they have had a professional relationship with for years—are becoming increasingly adversarial.

We've also seen a big drop in concern about the balance sheet. In 2010 during the fallout from the financial crisis, CEO's number one concern was cleaning up the balance sheet (70%). In 2011, the percent of CEOs concerned about the balance sheet was 49% compared to this year's 37%.

Getting Better Technology Mileage

The technology priority story has remained consistent from 2011 into 2012 with using technology for better efficiencies (55%) once again topping the list, followed by getting more value for existing technologies and vendors (43%).



The percentage of CEOs planning new systems purchases has increased to 40% in 2012 compared to 32% in 2011. Even with this increase in new purchases, we predict that 2012 will be another difficult year for vendors since bank CEOs report more interest in using the technology that they already have rather than investing in new systems or upgrades (although CFO/COO/CIOs have a different view).

Based on our experience negotiating several hundred vendor contracts in 2011, it remains a buyers' market. Vendors experienced an uptick in activity in the fourth quarter of 2011 after two very difficult years, but even with predictions for increased spending, they should be prepared for some

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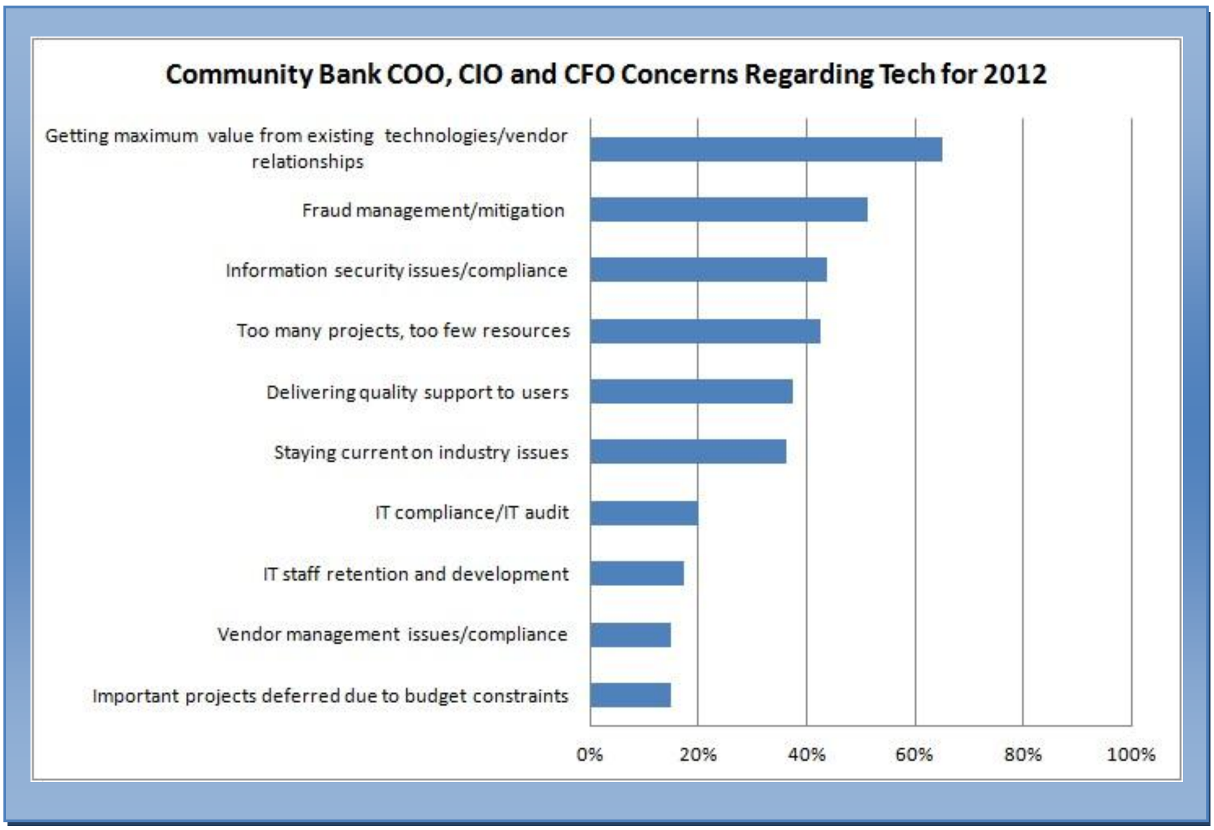
tough negotiating and to offer big discounts throughout the first half of 2012. More importantly—and as we've been preaching for 15 years — vendors should be pro-active in helping banks improve the use of their existing products to drive better efficiencies. Unfortunately, the majority of vendors remain more focused on new customers, new products and new revenues than on improving existing customer utilization and satisfaction.

The COO, CIO and CFO Perspective

Squeezing Value

For the third year in a row, the top technology concern for bank finance, operations and IT executives is getting maximum value from existing technologies and vendor relationships (65%). In fact, four of the top five technology concerns remain constant between the 2011 and 2012 survey. "Staying current on industry issues" is replaced by "Too many projects and too few resources" in 2012. In 2011, the third most pressing concern was information security/compliance; in 2012 it's moved down to number four.



The good news is that it's very easy to significantly improve technology utilization. It's been our experience that the real challenge is getting both the business lines and the IT function working together. Poor utilization is as much a reflection of management styles and bank culture as it is vendor failure.

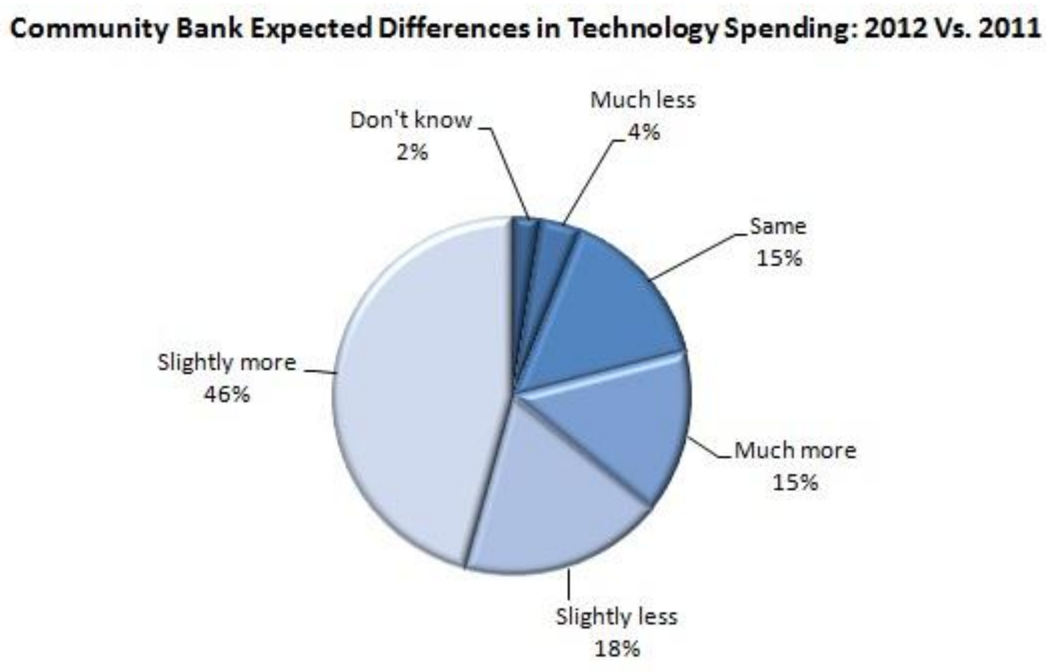
The good news is that it's very easy to significantly improve technology utilization.

Fraud management, named by 53% of the C-suite, is less pressing of a concern than it was in 2011 when 64% named it as priority. In 2011, corporate ACH fraud was a hot topic in banks and although still an important issue and number two on the list, community banks have either already addressed the issue or at least feel more confident that they will be able to address it.

Spending Starts a Slow Rise

Nearly two-thirds (62%) of COO, CIO and CFO respondents report that their technology spending will increase in 2012 which is consistent with the slight uptick in CEO optimism this year. Certainly, it's very difficult to cut technology spending since the bulk of any spending increases are those "built-in" non-discretionary spending increases such as increased volumes or users, inflation adjustments in contracts and increased employee benefits costs. We did see a number of 2011 projects (namely mobile banking) deferred until 2012 so increases in discretionary spending will likely be driven by some of these deferred projects.

For those CFOs, COOs and CIOs with technology budgeting responsibility, we recommend that you reconcile technology spending issues with your CEO.



For those CFOs, COOs and CIOs with technology budgeting responsibility, we recommend that you reconcile technology spending priorities with your CEO. Less than half (40%) of CEOs expect major technology purchases in 2012 and these executives may have unrealistic expectations about technology spending in 2013 as well.

Tech Purchase Plans and the CEO-C-Suite Spending Disconnect

Top 10 Project Priorities For Community Banks: New or Replacement Purchases	
Mobile banking	43%
Tablets, iPads	32%
Remote deposit capture - consumer	29%
Online account opening	29%
Mobile payments	28%
ATMs, hardware	26%
Fraud management, security tokens, etc	25%
Customer relationship management (CRM)	24%
Loan origination and underwriting systems	22%
Commercial Internet banking and other cash management systems	21%

Mobile banking is the number one (#1) purchasing priority for the third year in a row. Many mobile banking projects in 2011 were deferred into 2012 and now first time mobile buyers are asking if they even need a text or SMS version. With nearly 60% of US adults owning a smart phone (Javelin Research), the question has become do you roll out your iPhone or Android app first.

Tablets and iPads, which did not appear on the list of priorities at all in 2011 shows up at the number two (#2) spot. From what we've seen in board rooms across the country, it's become the must-have toy for Board members. Microsoft has termed this phenomenon the "Consumerism of IT" in which business users expect and even demand access to the devices they've become used to in their personal lives.

Consumer RDC was near the bottom of the list last year and jumped up to number three (#3) this year. Few banks, if any, are driving any fees or efficiencies from it, but many are responding to the very visible advertising campaigns from large banks such as Chase's QuickDeposit™.

The drive for online customer conveniences raises this question - if your customers aren't coming into the branch anymore and the majority of your sales processes are branch-based, how are you going to sell in the future?

> ***Online account opening continues to be a high priority project despite a disappointing return on investment.***

Online account opening promises to address this very issue, so it's no surprise that online account opening continues to be a high priority project (#4). Unfortunately, online account opening has been a disappointment in its most common form. It's CRM déjà vu all over again. Many CEOs have been convinced that simply adding online account opening systems will drive a flood of new account openings (just as CRM vendors convinced them that simply adding CRM systems would increase cross-sells). A technology-only strategy never works. If you do not improve your sales and marketing practices, online account opening will be a disappointment.

Mobile payments moved up the list (#5) even though the definition seems to be a moving target. Is it online bill pay through mobile? Is it person-to-person payments through Paypal? Is it mobile credit card akin to Google Wallet? Is it something like the Starbucks' payment app? Mobile payments is the Wild Wild West of community bank technology right now. Venture capital money is again being thrown at 24 year old programmers in Austin and the Silicon Valley. This time the money is going to the next cool mobile payments idea. But be warned – most of these emerging companies aren't focused on privacy, security, compliance or interfaces to your existing systems. So be sure you know what it is you are trying to accomplish, what your customers want, how you're going to secure it and how you're going to make money on it.

Mobile payments is the Wild Wild West of community bank technology right now.

In comparing the top technology project plans of C-suite executives with the list of CEO priorities, it appears that there is a disconnect and lack of alignment. While COOs, CIOs and CFOs are focused on convenience projects such as mobile banking and consumer remote deposit capture, community bank CEOs list growing commercial loans, gaining efficiencies and dealing with regulatory compliance as their top priorities. It appears that the COO, CIO and CFO might be traveling down a different strategic path from the CEO. In a year of tight budgets, technology/strategy alignment is critical.

The top technology projects for 2012 listed above won't move the needle on what CEOs are most concerned about and it appears that the COO, CIO and CFO is traveling down a different strategic path from the CEO.

Internet Banking Top Improvement Target

For the second year in a row, commercial Internet banking was the number one (#1) utilization priority. From our experience, there are huge utilization and penetration improvement opportunities available.

Top 10 Project Priorities for Community Banks: Improve Use of Systems	
Consumer Internet banking	40%
Commercial Internet banking and other cash management systems	40%
eStatements	38%
Bill payment	36%
Network Equipment/Storage/Server Virtualization	35%
Core processing system	32%
Debit/Credit/ATM/EFT systems and services	32%
Document imaging/document management/workflow (ECM)	32%
Remote deposit capture/merchant capture - commercial	32%
ATMs, hardware	29%

With all the focus on improving online capabilities, community banks' primary online channel is still grossly under used. Often, we'll see banks with less than 50% of their consumer checking accounts using consumer Internet banking (tied for #1 this year, #3 last year) and only 20% of those using bill pay. Even on the commercial side, we'll typically see 65% commercial Internet banking use and 20% bill pay use.

For those considering mobile, keep in mind that Internet banking use is the best indicator of mobile adoption. You can guesstimate about 20% of your Internet banking users will become mobile users in the first 18 months. So if you have low Internet banking penetration, you might consider addressing your overall online strategy before rolling out mobile.

eStatements was the third priority (#3). Again, there is plenty of room for improvement as adoption has been rather low. Even when banks have penetration success, it often still sends a paper statement so no cost savings are achieved.

Bill pay (#4) remains the single stickiest service for both consumers and commercial customers so if your penetration is low, consider marketing campaigns, 90 second how to videos, incentives, etc. to drive penetration.

Network utilization remains a high priority (#5). As many banks have begun to migrate to more of a virtual data center, network architectures are being revisited for additional scalability and cost savings. Additionally, as storage and equipment costs come down, banks are recognizing improved performance and cost savings.

Top 5 Project Priorities for Community Banks: Renegotiate Existing Contracts	
Core processing system	15%
Debit/Credit/ATM/EFT systems and services	14%
Bill payment	11%
Consumer Internet banking	10%
Branch capture	10%

For the third year in a row, the top target for contract renegotiations is core systems. The opportunity to renegotiate in-between contract renewals, which we have used very successfully the last eighteen months, remains, and we expect the big saving opportunities to continue at least through the second quarter. That strategy has been successful with these other listed contracts, so we would encourage your bank to consider renegotiating any contract with less than three years left.

From Survey to Action: Top 5 Bank Strategies for 2012

While survey results are helpful in benchmarking your bank against your peers, the real value is in translating those findings into actions at your institution. With that in mind, and based on our 2012 survey results as well as our consulting work with community banks throughout the U.S., the Abound Resources team recommends these five strategies for 2012.

1. Grow Revenues Through Advice-Based Sales and Integrated Commercial Strategy

With 75% of CEOs planning commercial loan growth and with C&I lending being only one of four loan portfolios that experienced growth last year (the others were multifamily residential, farm loans and farmland loans), it is clear that C&I lending will be a major focus of community banks in 2012.

But remember, in addition to great underwriting, the key to growing C&I lending is owning the entire relationship, and there is a strong correlation between cash management use and C&I lending. So for banks that may be diversifying away from CRE and haven't historically offered a competitive cash management program, now's the time to do it.

When we help banks with cash management programs, they typically have most of the products they need. What they're missing is the right packaging, pricing and sales model.

Those same things are also missing in the small business program.

Sales has always been a bit of a dirty word in community banks. Bank employees balk at the idea of being turned into a used car salesperson so many have instead evolved into order takers. If a customer knows what he or she wants and is willing to visit a branch or call a loan officer, employees are pretty good at guiding the customer to the best product and opening the account (i.e.: taking their order). But what about those customers who don't know what they need? Or those who don't know you have a similar product to the large national bank they just called for a quote? Or those who don't come into your branch or call your loan officer? Or those who aren't yet customers?

You need to continually drive awareness of solutions to customers and prospects so that when they need the solution (whether they know it or not), you can help them explore options. That's marketing.

When you do get that opportunity to sell, understand what's driving their need so you can understand and communicate whether your solution will solve their problem. That's sales.

If you want to survive, you must be willing to market and sell your products. While no one would suggest taking the hard-sales approach of the much-dreaded used car salesman, a consultative advisor who serves customers by understanding their needs and then recommending the right products and solutions likely fits with your brand and can be a point of differentiation from the big bank "hard sell" approach.

If you want to survive, you must be willing to market and sell your products.

The issue is whether or not CEOs are willing to make the investments and drive the cultural changes required to improve sales and marketing. Here, in no particular order, are the most common mistakes we see in small business and commercial sales and marketing:

- Lack of data to identify good prospects for products and campaigns. We remain an industry awash in data and devoid of actionable information.

- Wasted marketing dollars. Today, marketing requires more than placing an advertisement in the Sunday newspaper, posting interest rates on your website or sponsoring the local little league team. Community banks need to embrace electronic lead generation with tools that may include e-newsletters, webinars, Google AdWords and social media such as LinkedIn and Twitter. These do not replace traditional or offline tactics; they compliment them. The most effective marketing campaigns typically incorporate many different media.

- No competitive differentiation. If your marketing messaging highlights your great rates, great service, great locations and how you love small business, you have not yet identified your competitive differentiation. Every other community bank, credit union and even some big banks in your area say the exact same thing. What will make you stand out in a very crowded marketplace?

- Ineffective sales model. Typically, we'll see banks assign commercial loan officers responsibility for large commercial accounts and branch managers responsibility for small business. In reality, few commercial loan officers work to grow commercial deposits or fee income (they're "lenders" after all) and few branch managers ever leave the branch and call on small businesses. So most of your small business and commercial deposit opportunity goes untouched.

- Fear of setting sales goals. You get what you measure so don't ignore holding marketing employees accountable for lead generation and sales employees accountable for closing. Some business line managers are using the mortgage-focused incentive compensation regulations as an excuse to cloud the accountability issue but you can incent behaviors and remain in compliance.

- Jumping into sales training without building the proper infrastructure to monitor and measure results or doing one-time training instead of on-going coaching and reinforcement of sales techniques.

- Not rewarding your best customers with loyalty programs.

Each of these need to be addressed to evolve to an effective, advice-based sales model. The decision also must be made whether you will employ a product-focused sales strategy or an integrated relationship-based sales strategy.

In addition to improving sales and marketing, community banks must drive more fee income. That doesn't mean just raising fees and copying big bank strategies. Rather, it means driving cards and payments volumes, creating new small business programs and smart fee collection.

There is no slam-dunk new product that will solve the challenge of replacing fee revenue. As an industry, we became intoxicated on NSF/OD income and there's a pervasive feeling that a product will come along to replace it. We don't see any on the horizon, and even if there is a great product or service that promises new or additional sources of fee revenue, it seems likely in this environment that the Consumer Financial Protection Bureau or the court of popular opinion will pounce on it. Just ask Bank of America or Verizon how new consumer fees worked out for them.

So the real fee income growth opportunity is in the commercial and small business market through payment services (ACH, cards, RDC) that drive fee income. You likely already have most of the products you need for a successful business program. Now you need to tie it together with effective sales and marketing.

The fee income growth opportunity is in the commercial and small business market through payment services.

The solution to the revenue problem isn't new and it isn't sexy. The solution is better execution of fundamental sales and marketing techniques: competitive differentiation, target marketing, lead generation campaigns, sales targets, training and coaching, accountability and incentive rewards.

2. Redesign Workflow to Improve Efficiency

Improving efficiency and streamlining workflow were the CEO's number one and two (#1 and 2) cost saving priorities, yet workflow technology was #9 on the technology priority list. In our experience, workflow technology is the single greatest efficiency tool. Lots of banks have document imaging systems but still have lots of paper being passed around, and many don't use the workflow modules which allows you to actually automate the process.

Remember the story about the two guys in the 1800s who wanted to speed up transportation. One guy looked at the problems with the horse drawn carriage. Horses averaged about 6 mph and required stops for rest and feeding. So he built a mechanical horse that could go 10 mph and didn't need rest stops. The other guy built a train.

A lot of banks add workflow to the new accounts or loan origination processes and end up with a mechanical horse. They see incremental improvement and perhaps get their loan decisioning down from 2 hours to 1 or the new accounts process down from 30 minutes to 15. But to get your loan decisioning down to 7 minutes or your new accounts process down to 10 minutes (whether in branch, online or over the phone), you have to build a train.

You have to change the way you look at the process. You have to ask yourself why you do it that way. You have to be willing to change the policy. And you have to be willing to tell someone that what's worked for five years doesn't work anymore.

Redesigning the workflow coupled with workflow technology is how you get breakthrough efficiency and customer service improvements.

Proper vendor management can also drive efficiencies and was cited as a top 10 priority by C-suite executives. Although the term "vendor management" has become synonymous with the annual compliance process of gathering financials and Service Organization Control Reports (i.e., SSAE 16, formerly SAS70 reports), effective vendor management maximizes benefits (through utilization improvement) while minimizing costs (through contract negotiations) and manages risks (through better contracts, insurance, business resumption plans and the like).

We recommend including vendor management in your technology planning discussion so it becomes a governing concept rather than an afterthought you consider only when the examiners are due to visit.

3. Create a Technology Plan to Support Your Strategic Plan

CEOs tell us that they want to use technology to drive efficiencies (think document management and workflow or process automation) but our survey results show that COOs, CIOs and CFOs are instead focused on providing technologies such as mobile banking and online account opening that improve customer convenience. This disconnect can be very expensive to the bank and costly to the COO, CIO and CFO's career.

The best way to avoid a disconnect between the CEO and the rest of the C-suite and reap the most benefit from your technology spending is to create a technology plan that identifies the technology projects and purchases that align with the organization's strategic objectives. The plan ensures that bank strategy drives execution rather than the other way around.

> ***The best way to avoid a disconnect between the CEO and the rest of the C-suite is to create a technology plan.***

Technology planning begins with the bank's strategic plan (whether written or in the CEO's head) and is then built based on input from the business lines and IT about how to use technology to support that plan. The end result is the top five technology initiatives for the next three years with dates, dollars and accountability assigned. The plan should be reviewed, discussed and ultimately approved by the CEO (and perhaps the Board). Whenever the CEO or a business line manager approaches the CFO/COO/CIO with a new technology request, the executive can refer back to the plan. The question becomes: “Is this request more important than these top five, and if so, which of these five gets removed from the list?”

4. Explore New Regulatory Compliance Models

More than two thirds (67%) of CEOs responding to the survey named dealing with regulatory burdens as a top concern heading into 2012. Regulatory compliance is eating up more time and resources than ever before and the trend shows no sign of abating.

We recommend two key tactics to cost-effectively improve regulatory compliance. The first is to “bake” compliance and risk management into workflow or efficiency process improvements. For example, when redesigning your loan origination process, automate loan procedures and controls so you can capture and resolve exceptions before they become a reporting issue. Pay for an interface to minimize styling differences on legal names. Automatically notify the credit officer if a document is missing before you get to closing. Good systems should improve both efficiency and risk management.

Second, consider the emerging model of co-sourcing for regulatory compliance. Vendor management is quickly moving to a co-source model where banks use consultants to either help with large evaluation and negotiation projects or to run their entire program. Regulators expect you to add more people to stay current with compliance, but you will never be able to afford the number of experts required. Additionally, legal and consulting firms are expanding their staffs, creating a talent shortage and driving up salaries. Co-sourcing is becoming a cost-effective alternative to building expertise in house and adding to staff, and we recommend considering at least two different co-sourcing models:

> ***Regulators expect you to add more people to stay current with compliance, but you will never be able to afford the number of experts required.***

	In House Model	Co-Source Model #1	Co-Source Model #2
Compliance Functions			
· Advise	In House	Outsource	In House
· Monitor	In House	In House	Outsource
· Train	In House	Outsource	In House
· Manage projects	In House	In House	Outsource
· Audit	Outsource	Outsource	Outsource
Type of In House Personnel Needed	1-2 experts and several generalists	Several generalists with project management skills	1 compliance expert, typically an attorney in larger institutions
Pros	More control	Easier to staff, more expertise, less expense	Less expense
Cons	More expense, less expertise	Less control	Less control

One co-sourcing model outsources technical expertise and training while relying on internal staff to handle day-to-day projects and monitoring. Another outsources monitoring, reviews and project management while in house staff stays current on technical expertise and handles internal training. In either model, the bank still owns the process (it's co-sourcing, not outsourcing), but benefits from outside expertise. As an added bonus, examiners look more favorably on independent, external reviews.

5. Begin the Move to Enterprise Risk Management

Regulatory compliance is clearly a top concern of CEOs, but it is only one part of the broader risk spectrum facing community banks. As the OCC noted in June 2011 comments to the U.S. Senate, "The financial crisis underscored the need for bankers to adhere to the basic precepts of sound banking practice: prudent underwriting; strong risk management; diversified funding sources, adequate loan loss reserves and capital and strong corporate governance."

As many CEOs and Boards discovered over the past few years, strong capital and earnings doesn't guarantee careful risk management. Earnings and capital can quickly evaporate during a severe economic downturn as many banks that over concentrated in commercial real estate and acquisition, development and construction loans have learned.

"Banks with strong risk management practices, that proactively identify, measure, monitor and control risk will provide the greatest value to their customers, even in the most difficult economic environments."

Abound Resources recommends five key steps to manage enterprise-wide risk:

Step 1: Evaluate risk. Determine how much risk your bank can take, must take, and afford to take to reach its strategic business objectives. Prepare a comprehensive "risk appetite" statement. For example, calculate best, expected and worst case loss scenarios based on planned loan types and amounts. If you don't have sufficient capital to absorb the possible worst case scenario losses, rethink your strategy.

Step 2: Translate "risk appetite" into measurable risk guidelines. What amount of loss exposure is management and the Board comfortable with in different types of lending (i.e., direct vs. indirect, real estate, C&I, credit card)? Translate the risk appetite into specific industry and geographic risk concentration guidelines. Consider the risks of various types of commercial real estate loans since they differ significantly (office versus retail building use, owner-occupied versus non-owner occupied).

Step 3: Monitor and evaluate risk on an on-going basis and measure performance against risk guidelines. Identify key leading and lagging risk indicators and track them regularly. If the strategic business objective is to increase penetration of the "millennial" market, track the number of accounts sold to that group. If portfolio risk is driven by factors such as employment, home sales or new home starts, track those indicators. If the risk guidelines set a limit for commercial real estate loans as a percentage of capital, track that. Consider tracking the dollar-weighted risk grades of loans in particular segments to look for signs of deteriorating quality. Use forward looking, leading risk indicators, such as loans made as exceptions to credit scores or policy guidelines rather than lagging indicators like past dues.

Step 4: Implement an effective risk management structure. Consider outsourcing or co-sourcing as a cost-effective means to ensure sufficient, skilled resources are available for compliance, audit, loan review and IT security. Make sure that controls are effective and appropriate within your risk environment.

Step 5: Finally, investigate enterprise risk management (ERM) systems that automate risk assessments, create audit reports and track audit findings. These systems are still evolving and even if you are not ready to consider a purchase, you can learn a lot about the concepts of managing bank risk by viewing vendor demonstrations.

Remember that banks that proactively identify, measure, monitor and control risk will provide the greatest value to their shareholders even in the most difficult economic environments.

Conclusion

It's been a difficult few years for the entire financial services industry, including community banks. Many of those headwinds—including economic uncertainty and increased regulations—will likely remain throughout 2012. While community bank executives are resigned to leading in this "new normal," they won't be able to rely on business as usual type practices. Instead, we encourage community banks to look at new ways to drive sales and fee income, redesign workflows for better efficiencies, align technology purchases with strategic objectives, explore new compliance models and move towards enterprise risk management. The CEO, the executive team and the Board need to work together to ensure that each step they take, whether it be rolling out mobile banking or getting more functionality out of existing systems, is done with the goal of supporting the strategic plan.

It won't be an easy transition but in a time of compressed margins and tight budgets, it's a necessity.

About Abound Resources

Abound Resources is a full service management consulting firm with a sole purpose to help community banks achieve their goals whether in the areas of growth, efficiency, technology or risk management. In fact, we guarantee it.

Abound Resources offer an array of services designed to improve performance and profitability and help community banks cope with an increasingly stringent regulatory environment.

Our seven practice areas are each headed by an experienced practice leader:

- **Technology** – technology plans, vendor evaluations, contract negotiations, bank vendor management

- **Operations and Payments** – workflow improvement, efficiency studies, payments strategies

- **Lending** – loan process improvement, loan origination vendor evaluations and implementations

- **Small Business and Commercial Cash Management** – small business deposit and fee income growth programs, bank cash management programs

- **Strategic Planning** – bank strategic plans, risk tolerance planning, one page strategic plans, competitive differentiation

- **Sales and Marketing** – branch performance improvement, sales coaching and training, e-marketing strategies and campaign management

- **Risk Management and Compliance** – ERM, IT audits, information security assessments, compliance, BSA review

Abound Resources is proud to be endorsed by IBAT and ICBM.

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- ☐ Vendor Management Best Practices
- ☐ Core Decision in Next 30 Months? How to Save Money and Improve Performance
- ☐ 6 Ways to Save Money and Time While Complying with Vendor Management Regulations

Risk Management and Compliance

- ☐ Understanding The Consumer Financial Protection Bureau & How It Impacts Your Bank
- ☐ Developing the Enterprise Risk Management Infrastructure for Banks
- ☐ Three Specific Solutions for your Bank to Respond to Regulatory Change & Slow Economic Recovery
- ☐ Regulation Q Update White Paper

Strategic Planning

- ☐ Top Ten Reasons Your Bank Might Need A New Strategic Plan

Small Business and Commercial

- ☐ Small Business Market - an Untapped Source of Increased Fee Income for Banks

Operations and Payments

- ☐ Top 10 Best Practices for Consolidating Your Back Office
- ☐ 5 Keys to Improving Your Efficiency Ratio This Year
- ☐ The Right Way to Efficiency Improvements: Improving the Bottom-Line AND the Customer Experience
- ☐ The 3 Best Community Bank Technology Investments Today

Lending

- ☐ 5 Secrets to Successful Online Account Opening and Online Lending

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- ☐ Opt-In Secrets, Margin Management and Sales Success: The Other Side of Efficiency Ratio

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