The End of Community Banking

Creditworthy borrowers will be denied loans as small banks devote more and more energy to regulatory compliance.

By SARAH WALLACE

The comprehensive financial reform agreed upon by the House and Senate on Friday, along with all the new regulations of the past year, could signal the end of community banking. The new reforms will give more power to the Federal Reserve to regulate how my bank and others like it do business.

What does all this mean for our customers? Less credit will be available, costs will increase, and we will be less able to make loans to regular people who were creditworthy in the past. This is the perfect storm for the small retail banking customer. We will start to see more small community bank failures and mergers because of voluminous regulation.

I have served as the president and now the chair of the board of directors of First Federal Savings and Loan Association in Newark, Ohio, since 1980. First Federal is a $200 million, federal mutual thrift. We were created to provide people a safe place to deposit their money, and loan that money back into the community in order to meet housing needs. Additionally, we utilize a significant portion of our profits to give (yes, I said give—not lend) to worthy community organizations and projects.

Our business model is narrow. We have 55 employees. We are mortgage lenders and providers of retail deposit services. We have always been a major housing lender for low and moderate income workers in our community. Our borrowers work in government, agriculture, manufacturing, education and the medical profession, like any small community in the United States. For 76 years, this business model has served us, and most importantly, the people in our community very well.

Here is the problem as I see it. First Federal lends to creditworthy folks who for decades have been well-served by bankers who understand their market and can think creatively to structure credit appropriately. It is what community bankers do. Going forward, we will no longer be able to evaluate loan applications based solely on the creditworthiness of the borrower. We will be making regulation compliance decisions instead of credit decisions. This is not in the best interest of the consumer.

I have said to our employees many times, "We are in the business of helping people!" Sometimes, bad things happen to good people, people we see in the grocery store and at Little League baseball games. We used to believe that if someone hit a bump in the road of life and came to us for financing, we could often figure out a way to help them. I fear this kind of community-oriented banking will end. There will be creditworthy borrowers who will no longer be able to get loans.

Recently, a couple came to us wanting to refinance their home. They were paying a relatively high interest rate (by today's standards) to a competing institution. They had reasonably good

equity in their residence and owned a couple of rental properties, also with good equity. One borrower worked in the construction field and had experienced a reduction in income over the past couple of years, causing some recent slow payments on their credit report. After verifying the income and assets of the borrowers, an idea not new to us, we decided to deny the loan.

An argument could have been made to grant the loan because of the good equity position and due to the fact that we would have been lowering their monthly payment. However, fear of regulatory criticism through the federal examination process and potential money penalties associated with noncompliance were the overriding factors, causing the loan to be denied.

I had another customer stop in my office the other morning to ask how I thought the new bill would affect bank fees on checking accounts. My short answer was they will become more expensive, due in large part to the change in interchange fee regulation. It is estimated that banks on average will experience a 75% reduction in interchange fee income. In small banks like ours, interchange income offsets the expense associated with providing the service of electronic banking. Institutions will be faced with one of two choices: Either increase fees on checking accounts and continue to offer electronic banking, or stop providing the service altogether.

We all know the employees needed to provide banking services to deposit and loan customers: the manager, the teller, the back-office folks who balance the books, the loan officers and the customer-service representatives. In order to comply with the volumes of new regulation—and small banks are required to comply with the same consumer regulations that apply to the Wall Street banks—we will need to have a proportionately higher number of employees working day after day to interpret and implement all the new federal rules. This in itself, because of the sheer volume, has the potential to destroy community banking. Large banks have entire departments devoted to regulation compliance on a full-time basis; we have one employee, like most institutions our size.

The safety and soundness of our nation's small financial institutions is dependent on our being able to be profitable and add to our capital base. Small community financial institutions care about the people in their communities. Unfortunately, the new financial regulatory reform bill will greatly inhibit our ability to help them.

Mrs. Wallace is chair of the board of directors of First Federal Savings and Loan Association in Newark, Ohio.

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