# BANK DIRECTORS AND EXECUTIVE MANAGEMENT THOUGHTS ON STRATEGIC PLANNING FOR 2020

**BY PAUL ALLEN, CPA**

If you are like most community bankers, you are probably feeling about as refreshed and full of energy as a marathon runner at the 24-mile marker. No question, 2020 has been an overwhelming and surprising year, with no clear end in sight. And, with all the questions of what PPP loan forgiveness will actually look like, the uncertainty in local and global economic data, and the growing concerns about where we actually are in the credit cycle, no doubt the question "*What are you doing about Strategic Planning this year?*" is at least annoying, if not downright terrifying.

However, I want to encourage you to step back, take a breath, and consider what you'd probably tell your best customer if they asked you for advice on the same question for their business. In your role as their Trusted Business Advisor, you'd look them straight in the eye, pause a moment to make sure you have their attention, and then give them the right answer: in times of turmoil and uncertainty, you must set aside time to stop and consider what the right "next steps" are for your business, especially because of these "interesting times". And, I'd give you the same advice; your bank and your customers need the Management team to be on the same page, focusing on the most critical drivers of the business, acting versus reacting, and carefully navigating what appears to be choppy waters ahead.

Almost all community banks are facing the same basic banking challenges currently, and that list of challenges would be a great start in identifying the issues to discuss and consider during a Strategic Planning meeting in the current environment. Those challenges include:

### 1. IS OUR BALANCE SHEET COMPOSITION WHAT WE WANT IT TO BE?

Almost all community banks have experienced growth in 2020 that we didn't necessarily plan for. Of course, there are the PPP loans themselves, but most of us didn't expect the related growth in deposits, which have actually outpaced the dollar volume of PPP loans. Most of us expected those loans to come off our balance sheet pretty quickly, but with the delays in establishing the loan forgiveness process and the extension of the "covered period", we are realizing those assets will likely be with us longer than we expected. Also, the deposit inflows have been stronger and may stay longer than we expected. The Board and the Management team should take some time to consider, what do we expect our balance sheet and capital position to look like at year-end? What loans or earning assets will replace the PPP loans as they are paid off or forgiven? Given our loan origination skills and our market, what would we want our balance sheet composition to be if we set aside PPP?

### 2. WHAT IS HAPPENING TO OUR NET INTEREST MARGIN ("NIM")?

We moved into 2020 with historically low market interest rates, and asset yields have continued to creep downward. While our cost of funds is also low, we continue to struggle with having asset yields come down faster than cost of funds, and our NIM, already thin, continues to be pressured due primarily to the uncertain economic conditions both domestically and abroad. Some of that pressure may go away as we move through and out of the pandemic, but there is little support for asset yields moving up in the near or intermediate timeframe. That drives the need for Bank Management teams to be very focused on improving or at least maintaining the NIM. Since Net Interest Income is the largest component of bank income statements, reducing that income stream results in us having less resources to allocate for infrastructure, technology, introducing new products and services, and growing our markets. Because of

the importance of the NIM, bankers should be spending time on making sure the product mix is right, great customers are taken care of, unprofitable product lines and customers are identifying and culled out, and that Management is carefully selecting the best mix of assets, considering yield, term and risk profile.

### 3. WHAT CREDIT CYCLE ARE WE IN, AND WHAT IS THE LIKELY TREND FOR CREDIT QUALITY OVER THE NEXT YEAR?

Before COVID, in late 2019, the consensus of regulatory examiners, analysts, and most bank credit officers centered around the idea that the industry had experienced a long, very good credit cycle, but that cycle was either positioned to turn worse or already had during 2019. COVID and the resulting economic impact of shutdowns only made those economic conditions worse, however, because of the regulatory and accounting relief to allow substantial loan payment deferral programs, we are not likely to know the actual effect on credit quality until the fourth quarter of 2020. Strategically, the Board and the Management team should carefully consider the apparent risk profile of the Bank's loan portfolio against what the risk profile of the Bank may look like at the end of 2020 (as well as where credit quality is likely to go in 2021). That will require some careful analysis, and some thoughtful loan stress testing, but is critical as a foundation and for context in making other strategic decisions for the Bank over the next year or so. We learned the hard lesson in the last banking crisis, that the earlier and more proactively the Management team measures and monitors credit risk, the less the adverse impact on capital and future profitability.

### 4. DO WE HAVE THE TECHNOLOGY THAT WE NEED, AND ARE WE POSITIONED TO MITIGATE CYBERSECURITY AND FRAUD RISK?

Similar to credit risk, underemphasizing, and failure to allocate sufficient resources to minimize cybersecurity and fraud risk can completely offset great decisions made in the area of balance sheet composition and NIM. COVID didn't create that but has certainly underscored the importance of being flexible and nimble in reacting to significant changes in how our customers bank with us, how our employees work, and changes in the internal controls and fraud procedures we need in a remote/social distancing environment compared to a traditional banking environment.

One area that you may be able to put on the back burner or at least not spend as much time on, is operating expense – over the past several years, most banks have improved their efficiency ratios and have successfully driven operating costs down. While your bank may need some attention in this area (peer analysis is a great way to identify how you are doing, and whether this warrants additional time and focus), the four items or issues listed above will probably be the most impactful areas of discussion and analysis for most community banks.

While 2020 is not over, and it would be tempting to just "see how this thing turns out", we encourage you to set aside time with your Board and Management team to proactively discuss not only "where we are" but "where we want to be". And, as always, we are ready to help in any way we can, as a sounding board, to share what we've seen other banks do, or just to listen… after all, we're in this together.

Please **contact us** if you have questions and continue to check our **COVID-19 RESOURCE HUB** for sources of information and updates.

**About the Author | Paul Allen, CPA**
Paul is a shareholder in the Financial Institution Advisory Group of Saltmarsh, Cleaveland & Gund and the shareholder in charge of our Orlando office. He has over 25 years of public accounting and senior management experience, primarily serving financial institutions. Prior to joining Saltmarsh, Paul worked with an international accounting firm and served in various senior management roles with several financial institutions, including Chief Financial Officer.