CFOs Face Today’s Challenges Head-On

hedging lending deposits leadership management

Summary: CFOs at community financial institutions have their hands full now more than ever — low loan demand, an overflow of deposits, margin pressure, potential credit quality issues, and more. To give you some food for thought on how other institutions are handling these challenges, we share a few stories from your CFO peers.

Do you know the first known type of dinner plate was actually made out of bread? This medieval plate was called a trencher. While wood, pottery, and metal were also used for trenchers, bread was the main trencher substance used well into the 1500s. It was especially helpful in soaking up sauces, piling on the meat, and providing an easy way to season the food. Dinner plates have come a long way.

These days, CFOs at community financial institutions (CFIs) have a lot piling up on their plates, coming out of the clutches of the pandemic. Many are continuing to face lackluster loan demand amid strong influxes of deposits, which, in turn, has created excess liquidity and margin pressure. Some institutions stand to face potential credit quality issues among commercial borrowers in certain industry sectors, such as office space. Add to this, the potential risk of inflation and its impact on balance sheets, and CFOs’ plates are indeed overflowing.

Here’s what we are hearing from a few of your peers on how they are handling the current challenges.

1. **Lackluster loan demand amid strong influx of deposits.** Many institutions are wondering when their customers will start to use their deposits. One CFI CFO from SD, “*As chairman of our Funds Management Committee, I have never seen a period of such high liquidity. These funds have come into the bank, and it appears that our customers have a general reluctance or hesitancy to actually deploy them.*”

Knowing this, it makes sense to hear a Georgian CFO say that until loan demand is commensurate with the institution’s deposit growth, he will try to boost net interest income by finding appropriate investments. Many CFIs have turned toward securities, while they wait for the lending activity to pick up.

2. **Margin pressure.** A CFO at an institution in NM said that while deposit growth from the government stimulus payments to its customers has been good, it has put a squeeze on margins, making it challenging to control interest rate risk. Margins are also being suppressed by continued low rates, hampering interest income growth. While the industry’s average return on equity (ROE) is expected to start to recover this year, industry ROE won’t hit 11.7% until 2022, according to Deloitte.

Rising inflation is a real threat these days too. So, a CFO in TX is making sure to not “reach for yield” and risk earning fluctuations. Instead, he aims for a balance sheet that is either neutral or slightly asset sensitive. As you determine your institution’s strategy around margin pressure, it makes sense to set board expectations too, so everyone is on the same page.

3. **Credit quality issues.** After making a substantial number of PPP loans, another Texan CFO says there will be a *“need to determine the financial implications for the bank. I’m expecting some lumpy income streams in 2021 and 2022.”* Fortunately, as the economy continues to recover, institutions may not ultimately experience

as many charge-offs as they have provisioned, since the pandemic began, according to S&P Global Market Intelligence. The firm expects the industry to collectively release up to $13.26B in reserves through 2021, and another $13.88B in 2022. Still, working closely with your lending department to ensure that your customers can and do make loan payments is critical so that you can keep the number of charge-offs to a minimum.

4. **Increased profitability.** To boost profitability, you can either increase revenue or cut expenses. While both strategies should be on the table, some CFOs are expecting measured growth in the near term. The CFO from SD noted, "*I believe we will see most community banks taking a moderately conservative approach to growth for the next few years.*"

With low to no interest income, CFIs will need to think of additional income revenue. Gaining fee income through hedging products, international services, or even wealth management doesn't need to be difficult. If your customers are using international wires, for instance, you can help them increase their international business, while boosting your fee income.

Cost containment is also critical to increase profitability. We have seen CFIs automating more processes, with the increase in digital banking and achieving increased efficiencies. Looking at this area in more detail could help set your institution up for time and cost-saving measures. Furthermore, RBC Capital Markets expects many institutions, including CFIs, to boost profitability by buying other institutions to achieve better economies of scale and efficiencies.

CFOs are definitely busy these days. However, CFIs have always been nimble and responsive when faced with challenges in the past. Let's roll up our sleeves and get the job done.

NEED MORE FEE INCOME?

Financial institutions can earn additional fee income by adding monetization to a hedged loan. Learn more about how Borrower's Loan Protection® (BLP) can help you earn higher fee income today.

ECONOMY & RATES

Rates As Of: 10/27/2021 05:41PM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.06	0.02	-0.03
6M	0.07	0.02	-0.02
1Y	0.14	0.05	0.03
2Y	0.51	0.23	0.39
5Y	1.17	0.20	0.80
10Y	1.55	0.06	0.63
30Y	1.95	-0.09	0.31

FF Market	FF Disc	IORB
0.08	0.25	0.15
SOFR	**Prime**	**OBFR**
0.05	3.25	0.07

Copyright 2021 PCBB. Information contained herein is based on sources we believe to be reliable, but its accuracy is not guaranteed. Customers should rely on their own outside counsel or accounting firm to address specific circumstances. This document cannot be reproduced or redistributed outside of your institution without the written consent of PCBB.