Strategic Responses to the 2018 EGRRCPA at Bank Iowa

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Executive Summary

The 2018 Economic Growth, Regulatory Relief, and Consumer Protection act (EGRRCPA) is the first major change to banking regulations since the 2010 Dodd-Frank Act. This new law has particular impacts on banks in the $1-3 billion asset range such as Bank Iowa.

Bank Iowa, has $1.3 billion in assets and serves 22 communities in Iowa. Many of these branches are located in small towns that are losing population, but the bank also has branches in the suburbs of Des Moines, the fastest growing market in Iowa. Bank Iowa increased its Return on Assets by nearly 15% and its Return on Equity by 18% over the past 5 years. However, its growth lags comparable Iowa banks who have experienced growth in returns of 27% on assets and 22% on equity. Bank Iowa wants to bring its returns more in line with its peers over the next 5 years.

While Bank Iowa is a relatively large bank in aggregate, it is really an amalgam of many small banks. The bank's assets are spread broadly across the state. This complicates Bank Iowa's efforts to generate returns to scale in its operations compared to its peers, who are more concentrated in larger markets. As a result, Bank Iowa has higher total overhead expense over operating income than its peers, i.e., a worse efficiency ratio. By relaxing capital requirements on holding companies and easing restrictions on non-qualifying loans, the EGRRCPA provides Bank Iowa an opportunity to increase the scale of its operations in the growing suburban markets. While some of the growth will occur by expanding its lending operations in its existing banks, the relaxed capital requirements will enable Bank Iowa to acquire existing banks in its target suburban markets. As a result, it will be able to increase its volume of business more rapidly than its personnel and infrastructure costs, bringing its efficiency ratios more in line with

its peers. The benefits of these lower average costs of business can be spread broadly to its customers across all its community banks in the form of reduced costs of borrowing.

Introduction

In 1976, Donald Duncan, J. Robert Duncan, and Harry Barr purchased Citizen Bank in Clarinda, Iowa under the holding company Panhandle Aviation Inc. The holding company had contracted to build missile silos in Nebraska, and the bank operation helped facilitate the necessary transactions with other contractors and suppliers. Over time, the Duncans and Harry Barr purchased banks in 22 different communities that operated as seven branches. Each branch acted autonomously; each with its own regional president and separate lending authority. In 2012, these seven charter banks were merged into one charter under Bank Iowa. This allowed for consolidation of auditing, regulation, marketing, and other administrative functions.

While having most of their branches in predominantly rural areas, the aggregated Bank Iowa assets have grown to $1.3 billion, among the largest family-owned banks in the state. The size allows Bank Iowa to offer the financial services of a larger bank in its small-town locations. However, populations have fallen an average of 4% since 2000 in the 19 nonmetro bank locations. Meanwhile, the three banks located in suburbs of Des Moines serve communities that have averaged 77% population growth since 2000.

Reliance on a large number of relatively small banks in small towns causes difficulty generating the volume of business necessary to minimize the cost per dollar of net income. As a result, Bank Iowa pays $0.68 per dollar of net income, roughly 9 cents more than comparable banks in Iowa. Consolidating the 7 regions into 1 has helped build the fixed inputs necessary to centralize some of the services offered its member banks, but it now needs to spread the costs of

those centralized services across a broader scale of operations in order to profit from returns to scale. As shown in Figure 1, Bank Iowa anticipates that it can expand to $2.3 billion in assets without having to add appreciably to some of these centralized expenses, and that will allow it to take advantage of anticipated returns to scale, lowering its average costs per dollar of net income to its peer average or even lower. To do so, it will need to focus on further developing its suburban branches in the rapidly growing markets.

The 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) is the first major change to banking regulations since the 2010 Dodd-Frank Act. The purpose of the EGRRCPA is to support community banking and increase economic activity and lending in local communities that have faced slower growth. Some of the new regulations applied specifically to banks with assets between $1-3 billion, and so Bank Iowa with $1.3 billion in assets is a prime example of a bank to which this new law applies.

Financial Analysis

To demonstrate the growth strategy for Bank Iowa, we compare its financial performance to that of a group of peer banks. The peers we chose are American Trust and Savings Bank, Dubuque Bank and Trust Company, United Bank of Iowa, Quad City Bank and Trust, Northwest Bank, West Bank, and First Citizens Bank. The peer bank group was selected because they are located in Iowa and so they face comparable market challenges and opportunities, and because they are of similar size over the time frame for our analysis. We will see that Bank Iowa is disadvantaged because of its commitment to providing financial services to small towns that are in decline, but that it has the potential to match its rivals by expanding in the growing segments of its customer base.

Earnings Performance

As shown in Figure 2, Bank Iowa increased its Return on Assets (ROA) by nearly 15% over the past 5 years, and its Return on Equity (ROE) rose by 18%. This gain lags the peer group, which gained 27% growth in ROA and 22% in ROE over the time period. The difference in performance came despite Bank Iowa's aggressive efforts to gain some efficiencies by centralizing administrative functions. With 14 of its 22 banks in shrinking communities, Bank Iowa cannot fully benefit from its investments in consolidating administrative functions because it cannot grow its business at the same pace as its rivals who have a greater share of their assets in urban and metropolitan areas.

Loan Portfolio Composition

Due to the structure of Bank Iowa, they have a small commercial loans portfolio but they reach a broader market in agricultural based loans. Referring to Figure 4, in 2014 Bank Iowa held almost 59% of its loans in real estate, which is comparable to their peer group average. In the same year, commercial loans made up 12% of their loan composition, well below their peer group average of 20%. Over the past five years Bank Iowa has increased its real estate portfolio while reducing its exposure to commercial loans. They did this by issuing more mortgages in the rapidly expanding urban markets. By 2018, Bank Iowa had increased its real estate loan share by 9 percentage points in 5 years to 68% while its peer banks had increased their real estate share only to 63%. Meanwhile, Bank Iowa's commercial portfolio share remained at 10%, half of their counterparts. The other notable difference between Bank Iowa and its peers is the importance of agricultural loans. Despite steadily decreasing every year, Bank Iowa's emphasis on agricultural loans was consistently above its peers.

Another unique aspect of Bank Iowa's business is that 88% of its operating income comes from interest bearing sources (Figure 5). Bank Iowa has a small trust department while its peers derive more income from this business. Due to inadequate volume Bank Iowa struggles to compete among its peers and has decided to eliminate all trust management during the 2019 fiscal year. The bank would like to lower its exposure to interest income by increasing its earnings from loan origination fees in the secondary market. To do so, it would need to greatly expand its presence in the growing suburban markets around Des Moines.

Asset Growth

In the last 5 years, Bank Iowa realized total loan growth of 21% which fell significantly short of its peers' growth of 27%. Bank Iowa realized strong growth in real estate, but was hampered by large decreases in its individual and agriculture loans in the shrinking markets. Due to the downturn in the agricultural economy, Bank Iowa has written fewer agricultural loans every year. Loss of agricultural business caused Bank Iowa to shift its portfolio towards low interest rate risk-free US Treasury securities. Despite total investments decreasing since 2014, Bank Iowa realized a net earning assets growth of 11% (Figure 8), less than half its peers.

Capital Levels

Bank Iowa has consistently maintained lower levels of capital compared to its peers since 2014. Bank Iowa's lower capitalization ratio should have enabled it to grow faster than its peers, but that has not happened because if its higher business costs. If it can increase the scale of its business and lower its costs per dollar of net income, it has the potential to take advantage of having a lower capitalization ratio and begin to grow its assets on par with its peers.

Liquidity

To measure liquidity, we collected data on the Net Non-Core Fund Dependence. Bank Iowa was more liquid in 2014 than its peers. In contrast, the other 4 years the peer group held a higher liquidity ratio. Bank Iowa has created more liquidity risk in the last 5 years while the peer group increased liquidity, mitigating their risk (see Figure 8). With that being said, both Bank Iowa and its peers are consistently within the liquidity guidance levels advised by the Conference of State Bank Supervisors (CSBS). As shown in Figure 9, Bank Iowa's loan to deposit ratio is well above the CSBS minimum threshold of 75%. Consistent with its capitalization ratios above norms, Bank Iowa has a substantial cushion to survive adverse income shocks.

Efficiency

The focus of the Bank Iowa strategic plan will aim to improve its efficiency ratios. As shown in Figure 10, Bank Iowa is facing rising costs of generating net income while its peers are lowering their costs. The gap had risen to more than 9 cents per dollar by 2018. The rising gap in efficiency ratios must be reversed if Bank Iowa is to improve its ROA and ROE and asset growth compared to its peer banks.

In Figure 1, we lay out a possible growth strategy for bank Iowa. As of 2018, Bank Iowa had $1.27 billion in assets and an efficiency ratio of 68.8%. Bank Iowa has the infrastructure to serve a much larger asset base, but it needs concentrate this asset growth in areas with growing populations. Otherwise, it will not be able to lower its average costs as it increases scale. Its corporate headquarters in West Des Moines are in the middle of the fastest growing market in the state. If it can add assets in these urban and suburban markets and spread its fixed costs across a larger base of business, its efficiency will improve from increasing returns to scale.

Regulatory Compliance and Burden Assessment

Prior EGRRCPA passage, the most burdensome regulations for Bank Iowa were in residential real estate. The 2014 Regulation Z Ability to Repay and Qualified Mortgage Rule (Regulation Z) and the 2015 Real Estate Settlement Procedure Act-Truth in Lending Act Disclosure Integration (RESPA-TILA Disclosure Integration) imposed the greatest costs.

Regulation Z requires that creditors verify and document that borrowers have the ability to repay closed-end credit transactions by satisfying eight underwriting standards: income or assets, employment status, projected monthly mortgage payments for the loan, projected monthly payment on any simultaneous loans secured by the same property, monthly payments for property taxes and insurance and other property related costs, debts/alimony/child support obligations, monthly debt-to-income ratio, and credit history. These regulations could limit access to credit because some banks chose to limit their loan origination to Qualified Mortgage loans[1] to mitigate the legal risk of not complying. Prospective borrowers who did not meet the standards could be denied credit. For example, self-employed borrowers who relied on tax return income to repay their loans could be excluded because they did not meet the standard criteria. Regulations also restricted Qualified Mortgage status to loans that did not involve prepaid points or fees above proscribed limits. The cap on points and fees caused lenders to restrict terms to loans that earned more on recurring interest payments rather than from upfront payments, even if the borrower preferred to pay more at first. The caps meant that borrowers had less control over the interest rates they could pay.

The 2015 RESPA-TILA Disclosure Integration was also burdensome. By combining the required application and closing disclosures for consumer-purpose, the time to close a loan lengthened from 45 to 60 days. The costs to borrowers increased due to increased compliance costs for banks to implement regulation.

Bank Iowa's Compliance Department is made up of a Compliance Director, two Compliance Analysts and a Bank Secrecy Act (BSA) Analyst. The Compliance Director supervises the Compliance Analysts and the BSA Analyst. The Compliance Director's job functions include being responsible for developing, implementing, and administering all aspects of the bank's compliance program, the BSA, the Community Reinvestment Act (CRA) and the Home Mortgage Disclosure Act (HMDA). Some of the core responsibilities of the Compliance Director are to analyze new and pending laws and regulations which directly affect the bank's practices, and to develop, revise and implement policies, procedures, contracts and agreements to ensure compliance. Compliance Analysts collaborate with the Compliance Director to remedy weaknesses identified through monitoring and to coordinate mandated reporting of HMDA and CRA data.

A resource Bank Iowa uses for BSA compliance is Verifin, a fraud detection and anti-money laundering software. This software provides Bank Iowa information on transactions that look suspicious, at the cost of $30,000 per year.

Quantifying Regulatory Costs

The EGRRCPA has numerous potential effects on community banks. Table 1 summarizes the various features of the act that could potentially affect a bank, and the ones that most directly affected Bank Iowa.

Table 1: Review of Relevant EGRRCPA Provisions and Impact on Case Study Bank

EGRRCPA Provisions and Impact on Case Study Bank			
		$ Impact expected by year end 2019	
Provision	**Benefit Bank Y/N**	**Balance Sheet**	**Net Income[1]**
Simplified Capital Rules	No	No Impact	No Impact
Small bank holding company threshold	Yes	+160,000,000[2]	+$15,500,000
Highly Volatile CRE	No	No Impact	No Impact
Qualified Mortgage	Yes	+ 77,000,000[3]	+ 36,000,000
Escrow requirements	No	No Impact	No Impact
HMDA	No	No Impact	No Impact
Waiting period on credit offers	No[4]	No Impact	No Impact
Exam cycle	Yes	No Impact	+ 35,000
Volcker Rule	No	No Impact	No Impact
Short form call report	Yes	No Impact	+ 4,000

[1]Assuming all other factors remain the same
[2]Bank Iowa's current capital ratio multiplied by projected asset volume
[3]Under the assumption that all Real Estate Loans Bank Iowa issues are mortgages, and that Bank Iowa will see an increase of 12.5% in mortgages.
[4]The change is so modest that any effect would be negligible.

The new law states that banks with assets of less than $10 billion that exceed the 9% Community Bank Leverage Ratio will be deemed to be in compliance and are well capitalized, exempting them from risk-based capital requirement. We expect that Bank Iowa will see no impact in the near future regarding Simplified Capital Rules because the bank was well capitalized, both before and after the new rule. However, as Bank Iowa becomes comfortable, they will reduce their leverage ratio. Bank Iowa's leverage ratio will be dependent on their growth through acquisition, which will put stress on their capital.

The new law states that banks with assets less than $10 billion automatically qualify for Qualified Mortgage status for certain mortgages they originate and retain. By allowing banks to forgo certain requirements regarding residential mortgage loans, borrowers who may not have qualified previously will have better access to mortgage products. Bank Iowa will be able to

issue more qualified mortgages than previously, and the changes will also create efficiencies from loan application to closing. In consultation with bank officials, we estimate that the bank could add 12.5% to its mortgage business as a result of this regulatory reform.

Banks with assets of less than $5 billion will benefit from a filing a short form call report in the first and third quarters of each year. Bank Iowa will not be required to file full call reports for the holding company on a quarterly basis. By shortening call reporting for the holding company, Bank Iowa will save some employee time, resulting in modest savings of $4,000-$5,000 a year.

Spreading Costs

The new regulations open up new possibilities for Bank Iowa. By taking advantage of deregulation of bank holding company debt ratios, Bank Iowa may more easily expand capacity through acquisitions. Relaxed mortgage requirements will enable an expansion of the qualified mortgage program. Bank Iowa believes it can significantly increase its scale of operations, spreading its fixed costs across a larger asset base and improving its efficiency. This growth will come in two forms; increased same-branch business in its existing locations and expanding its presence in growing urban or suburban communities.

If Bank Iowa wants to increase its volume of mortgages, it must do it in the growing sector of the market, urban and metro areas. Being able to sell more mortgages in this market versus slower growth markets allows the bank to originate a larger number of mortgages. By selling these newly created mortgages, they can use the origination fees and sometimes the servicing fees to originate more loans. Capturing more origination fees and selling their newly created mortgages will provide community banks a steady stream of interest to expand into the

faster growing urban sector. By selling more qualified mortgages onto the secondary market, banks remove risk from their books, which they can use to originate more loans.

In order for a bank to service conventional loans sold on the secondary market, it must have staff and servicing software, reporting procedures with all 4 national credit bureaus, and must follow all of the compliance requirements associated with escrow accounts. Escrow account requirements include conducting analysis to determine how much the borrower must deposit in the escrow account at inception; preparing an initial escrow account statement to the borrower; computing the monthly escrow account payments for the next year; using the initial and annual escrow account analyses to determine whether there is a surplus, deficiency, or shortage; and preparing and submitting an annual escrow account statement. To avoid errors, banks must have critical fixed inputs including trained staff and error-correction software. As a servicer, if a loan defaults, banks are required to perform certain tasks associated with the foreclosure before banks are paid in full by the note holder. These fixed costs can be substantial. However, once the infrastructure is in place increasing the volume of mortgage origination can occur without having to add additional fixed inputs.

Banks that are able to open new branches in the rapidly growing suburban markets make their employees more efficient because there is more potential to originate new mortgages. Banks can increase their profit margins if they are able to spread their fixed costs of loan origination across a larger volume of business. Because the small towns in Iowa are shrinking on average, Bank Iowa will not be able to increase its volume of qualified mortgage origination in their small town banks.

It is possible that the small town banks will be able to expand their volume of non-qualifying loans. The rural customer base is composed of many farmers and other self-employed households whose taxable incomes may not reflect their true incomes. Households claim little income, as much of their revenue is reinvested in their farm or business and is absorbed in equity. In addition, it is hard for these households to separate their business costs from their household expenses and tax law incentivizes treating many expenses as business items. The problems are compounded when the place of business is also the place of residence. The consequence is that loans to farm and self-employed borrowers will often fall outside the requirements of a loan eligible for the secondary market. Rural lenders find it particularly difficult to comply with Appendix Q, which deals with thresholds for the ratio of income to debt self-employed borrowers.

The past regulations effectively limited the bank's ability to approve these kinds of borrowers, lowering net income on nonqualifying loans by as much as 2%. The new regulation protects banks from taking on the liability of riskier loans. Every loan that the bank retains and services in house is automatically regarded as a qualified mortgage. Customers' ability to sue banks with assets under $10 billion for ability to repay is restricted due to this. Banks need to perform a series of tests to ensure the borrower has the ability to repay in order to limit the risk to the bank as well as ensuring the borrower is not taking on too much personal debt. Banks only have to maintain a *reasonable belief,* supported by documentation, that the borrower is capable of repaying the loan. The bank can issue these loans at higher interest rates to compensate for the added risk, but banks with superior information on local farm and self-employed borrowers can assess risk more accurately than can automated formulas employed by nonlocal banks. If a bank

does not perform its due diligence in the underwriting of a loan, the bank is still liable for the deficiencies in the debt in the event the borrower defaults.

Strategic Growth Options from EGRRCPA

While Bank Iowa will be able to increase its volume and potentially interest income from mortgages by taking advantage of the expanded qualified mortgage rules, this will most likely not generate a large enough increase in assets. Most of these loans will originate at Bank Iowa's branches in the small communities; many of which are facing declining populations. While the volume of mortgages in small markets could potentially expand modestly, the main growth will occur in more rapidly growing suburban markets. In these communities, Bank Iowa is poised to expand its loan origination business by continuing to originate loans that can be sold to the secondary market, as well as expanding its origination of loans not eligible for the secondary market, but still qualified, and, therefore, safer. However, a third strategy for growth is to repeat Bank Iowa's strategy of acquiring new banks, but focusing specifically on acquisitions in growing suburban markets. The new regulations may make it easier for Bank Iowa to use leverage to do so. Additionally, organizational structure decisions by Bank Iowa's management will play a role.

The new leverage ratio rules mean that Bank Iowa's holding company and its banks can have different leverage ratios. So, not only can Bank Iowa issue riskier debt, but it can also take on more debt to spur growth as well. CFO Jon Sarvis suggests that, were the bank to issue bonds to fund an expansion, market participants would provide leverage up to 50% of their assets. While their immediate plans would not expand immediately by that amount, the option to expand through leverage would allow Bank Iowa to acquire other banks.

CEO Jim Plagge believes that Bank Iowa has the organizational infrastructure to expand. Existing personnel and information technology in the central office would be sufficient to manage an operation with nearly double the assets of Bank Iowa. The targets for this kind of growth would be in suburban or urban markets with a particular focus on the Des Moines metropolitan area, the fastest growing market in the state. As an example, our team has identified a suitable target bank that is for sale in the Des Moines metropolitan area. This bank currently has $250 million in assets, has a history of family ownership, and is in a suburban market that has doubled in population since 2000. The acquisition of other banks is one tradition carried over from family ownership that may prove to be advantageous in Bank Iowa's plan for growth. However, the tradition of keeping the bank in a small number of hands may keep Bank Iowa from fully capitalizing on the new regulations.

Exploiting returns to scale, Bank Iowa expects to lower its costs per dollar of net income from 68.8 cents per dollar to 56.7 cents per dollar (Figure 1) at an asset level of $2.3 billion. As shown in the simulation summarized in Table 2, as the bank increases its net income by 80.2%, it will only be increasing salaries and benefits by 55.3% and its facilities expenses by 35.4%. As it increases income faster than expenses, its efficiency ratios will improve, reaching their peer averages by 2023. By that time, assets per employee will have risen 41.3%.

S-Corporation or C-Corporation?

Bank Iowa has been an S corporation since its inception in 1976. S corporations must be closely held with no more than 100 shareholders. Income is taxed under Subchapter S of Chapter 1 of the Internal Revenue Code. The corporation itself pays no income taxes, and instead the owners of the shares are taxed on income generated from bank distributions. Recent changes in

the tax code have started a conversation among executives and officers about whether reclassifying as a C corporation would be beneficial. As a C corporation, the bank would have previously been taxed 35% at the federal level, as well as 12% at state-level. However, the tax code changes have lowered the corporate tax rates to 22%, inducing management to consider the costs and benefits of switching to a C corporation.

Currently, Bank Iowa pays out 38% of its earnings to shareholders, composed of members of the families that founded the bank. This is the combination of a 23% distribution required by S Corporation rules and a 15% payout used as a return on investment to these family members. Under the S corporation rules the owners pay their normal income tax, including on the 15% payout, which is as high as a marginal rate of 39.6% in Iowa. They also pay whatever capital gains tax applies to gains made by the bank. By contrast, under C corporation rules, the bank itself would pay an effective 17% corporate tax rate, reducing profits, and the owners would only pay capital gains tax and a dividend tax rate of 22% if applicable depending on the performance of the bank.

The decision between S and C corporation designation for Bank Iowa is a difficult one for two reasons. As mentioned previously, there is a tradition of family ownership at Bank Iowa. The owners' dedication to the bank makes a move to C corporation harder, as shares would be less closely held and family control might be diminished. The owners prefer to retain control even if it means the members pay more in taxes as a result of S corporation rules. Also reducing the incentive to transition to C corporation status is that Bank Iowa itself would have to pay taxes exceeding what it currently pays out from its earnings, although much less in comparison to corporate tax rates before the 2016 federal tax code changes.

Worth noting, is that once a firm transitions to a C corporation, it must remain a C corporation for 5 years. This introduces political risk over future corporate and personal income tax law. A change in political power could reverse of even increase marginal corporate tax rates which would negate any current benefits from changing the corporate charter. What could make staying an S corporation less beneficial, however, is the opportunity cost of potential growth when paired with new EGRRCPA regulations. According to the CFO Jon Sarvis, C corporation rules offer greater opportunities to raise capital at lower cost than under the present S corporation rules. C corporation rules would broaden the sources of financing across a wide spectrum of potential investors rather than limiting financing to the existing shareholders and/or bond financing. The greater ability to raise funds through common stock, with no immediate requirement of a dividend payments, could allow Bank Iowa to grow rapidly in size, with enough capital to expand mortgage programs and acquire even more banks. In doing so, the bank could benefit from a significant reduction in its cost per dollar of net income. Therefore, foregoing this option could be a huge loss of potential gains for Bank Iowa.

PART IV. LOOKING FORWARD

Strategic Competition and Expansion

While EGRRCPA immediately affects Bank Iowa's finances and future business strategies, it also affects the communities and customers that Bank Iowa serves. Bank Iowa reaches customers in its markets by differentiating itself against similar community banks and by competing against large loan originators that have national reach but lack local knowledge. Although these large loan originators beat Bank Iowa in marketing reach, Bank Iowa is able to offer lower rates by using its superior information on the credit-worthiness of each applicant. It

can also more closely tailor its loans to customer needs because the large loan originators aim to be able to sell all their loans to the secondary market and will not be willing to adjust terms if that makes the mortgage ineligible for the secondary market.

Few of the new regulations will change how Bank Iowa competes and differentiates itself from similar banks. Since most banks in their peer group and communities they serve are well under $10 billion in assets, any new rules that affect Bank Iowa will also affect these banks. However, two changes that will have an impact are the community bank leverage ratio and the holding company threshold change. While Bank Iowa will still be considered well-capitalized, potentially other banks of their size that have a higher leverage ratio will now be considered well-capitalized as well. Bank Iowa may have to adjust to more banks being able to hold lower amounts of capital and leveraging more aggressively to meet their growth goals. This could increase competition in loan writing, depository accounts, or even bids on banks up for sale.

In relation to large loan originators, these regulations will allow Bank Iowa to compete even more effectively. Since mortgages originated and kept by Bank Iowa will now automatically be qualified mortgages, Bank Iowa can write more business with less risk of default or legal processions. Large loan originators will still stick to making mortgages that are eligible for the secondary market and therefore will not be able to access the consumers that need a more tailored loan. While this will certainly not push these loan originators out of the market entirely, it will bolster Bank Iowa's volume of mortgages in comparison to them.

The most advantageous part of these new regulations is not necessarily related to how Bank Iowa competes for market share in its current market, but how it allows Bank Iowa to enter new markets. The ability for Bank Iowa's bank and holding company debt ratios to vary will be

valuable to Bank Iowa's aspiration for growth, as the holding company will be able to issue larger amounts of debt (up to 50% of their assets) in order to acquire new banks. Bank Iowa could expand up to $2.29 billion in assets while improving its efficiency ratio from 68.8% to 56.7%. This will bring Bank Iowa more in line with its peers in return and costs.

Future Regulatory Focus

The regulatory changes certainly have the potential to help banks in Bank Iowa's position. To that end, we see the best place for Congress to focus is continuing to roll back stringent regulations. CEO Jim Plagge feels that compliance has become very costly, especially for smaller banks. Easing compliance requirements, much like the introduction of the short form call report and longer exam cycle, can help banks of Bank Iowa's size and smaller immensely by either freeing up employees that do compliance as one part of their job to do other things, or reducing the size of the compliance department as a whole.

What may be the most important to regulatory policy is consistency. Bank Iowa has not taken advantage of many deregulations due to political uncertainty. Bank Iowa does not want to repeatedly incur costs in order to implement policies based on current regulations, and later undo them due to reinstating of similar policies. Much like many government policies, those affected will only take full advantage if they assume the changes to be permanent. Therefore, if Congress wishes for the policies they enact to work as intended, they must attempt to make the changes seem more permanent. While this is a difficult task for a legislative body with an everchanging composition, in the long run this would prove beneficial to community banks.

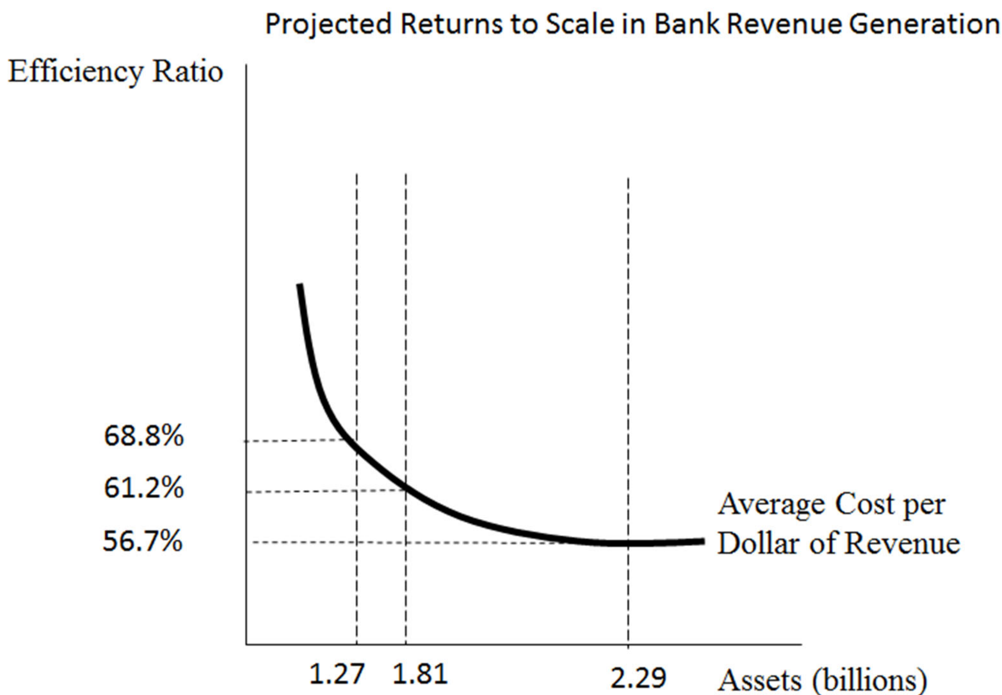
Less strict compliance rules in combination with the ability to fully take advantage of regulations would lower costs for banks by allowing them to lower related costs. For instance,

the average 30-year mortgage rate in Iowa is 4.275%/ year. The median home price is $159,900. Suppose this further deregulation causes the interest rate to drop by just 25 basis points to 4.025%/year. The reduction in interest would lead to savings of $23/month, which adds up to $8,280 over 30 years, even without adjusting for interest earned. If each community member that benefits from these lower interest rates chose to invest the money they save by redepositing it in the bank, opt for a higher principal loan to make up the difference, or spend the money elsewhere in the community, this could effectively stimulate local economies with millions of dollars.

Bibliography

Federal Financial Institutions Examination Council. Various years. *Uniform Bank Performance Report* https://cdr.ffiec.gov/public/Default.aspx

Figure 1: Projected Bank Iowa long run average cost per dollar of net income as a function of Bank Iowa assets



Note: Efficiency ratios and asset levels are derived from Table 2, years 2018, 2021, and 2013

Figure 2: Bank Iowa return on assets compared to peer Iowa banks, 2014-2018

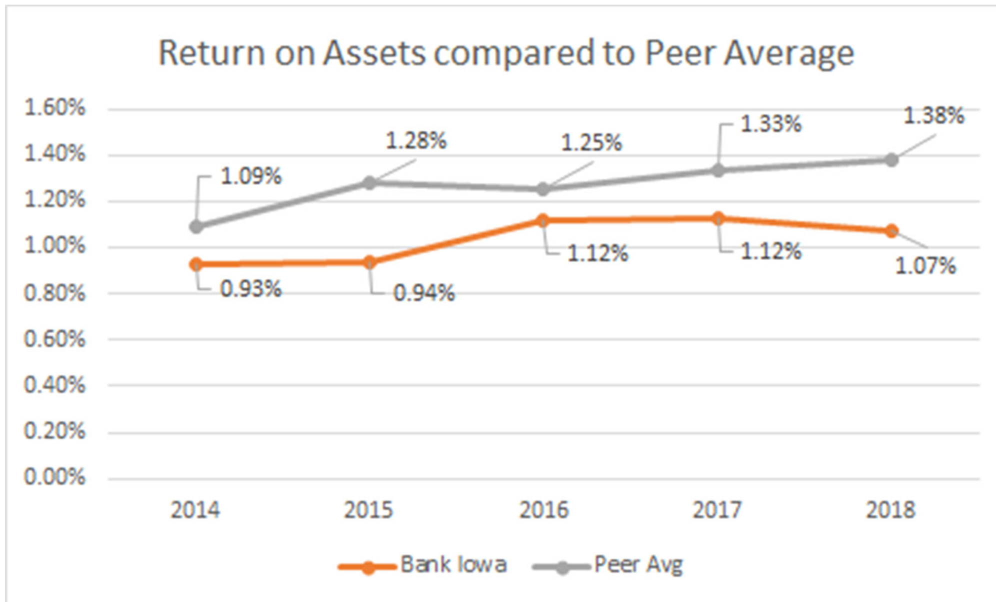


Figure 3: Bank Iowa return on equity compared to peer Iowa banks, 2014-2018

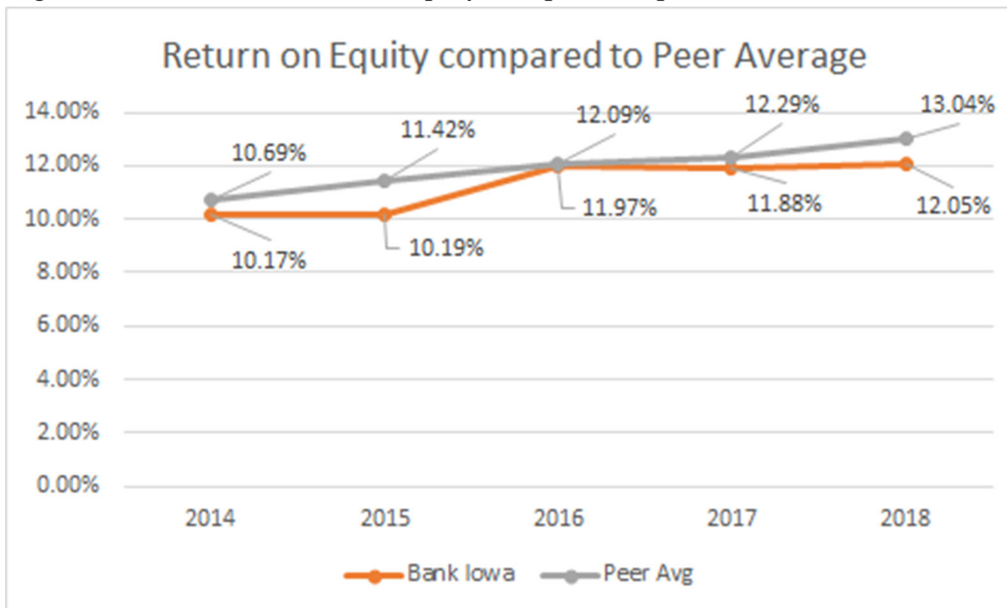


Figure 4: Bank Iowa loan composition compared to peer Iowa banks, 2014-2018

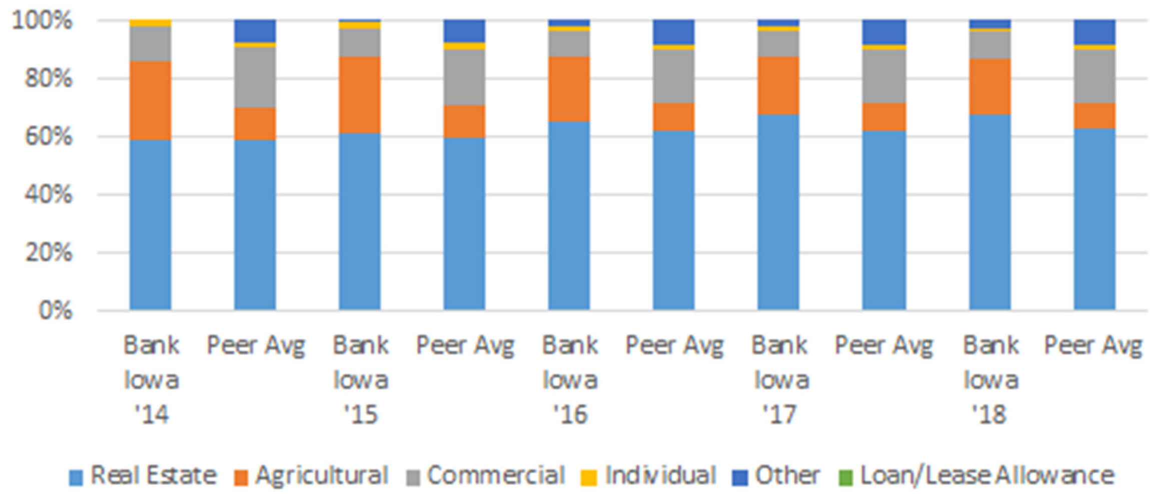

Loan Composition as a percentage compared to Peer Average
100%
80%
60%
40%
20%
0%
Bank Iowa '14
Peer Avg
Bank Iowa '15
Peer Avg
Bank Iowa '16
Peer Avg
Bank Iowa '17
Peer Avg
Bank Iowa '18
Peer Avg
Real Estate
Agricultural
Commercial
Individual
Other
Loan/Lease Allowance

Figure 5: Bank Iowa operating income by source, 2014-2018

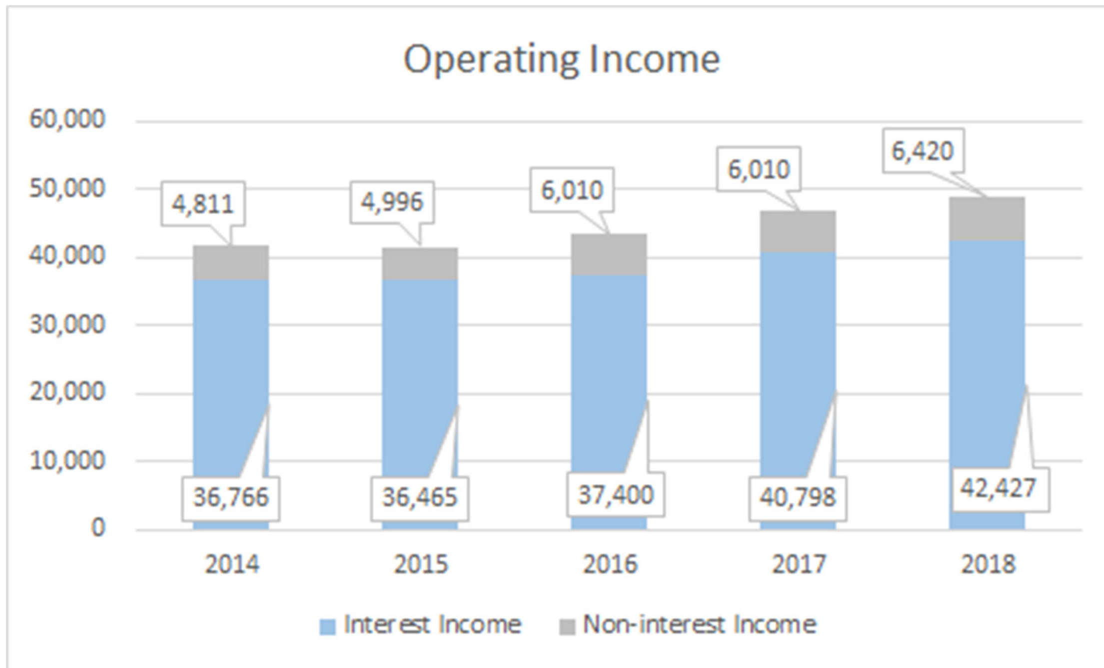


Figure 6: Bank Iowa asset growth compared to peer Iowa banks, 2014-2018

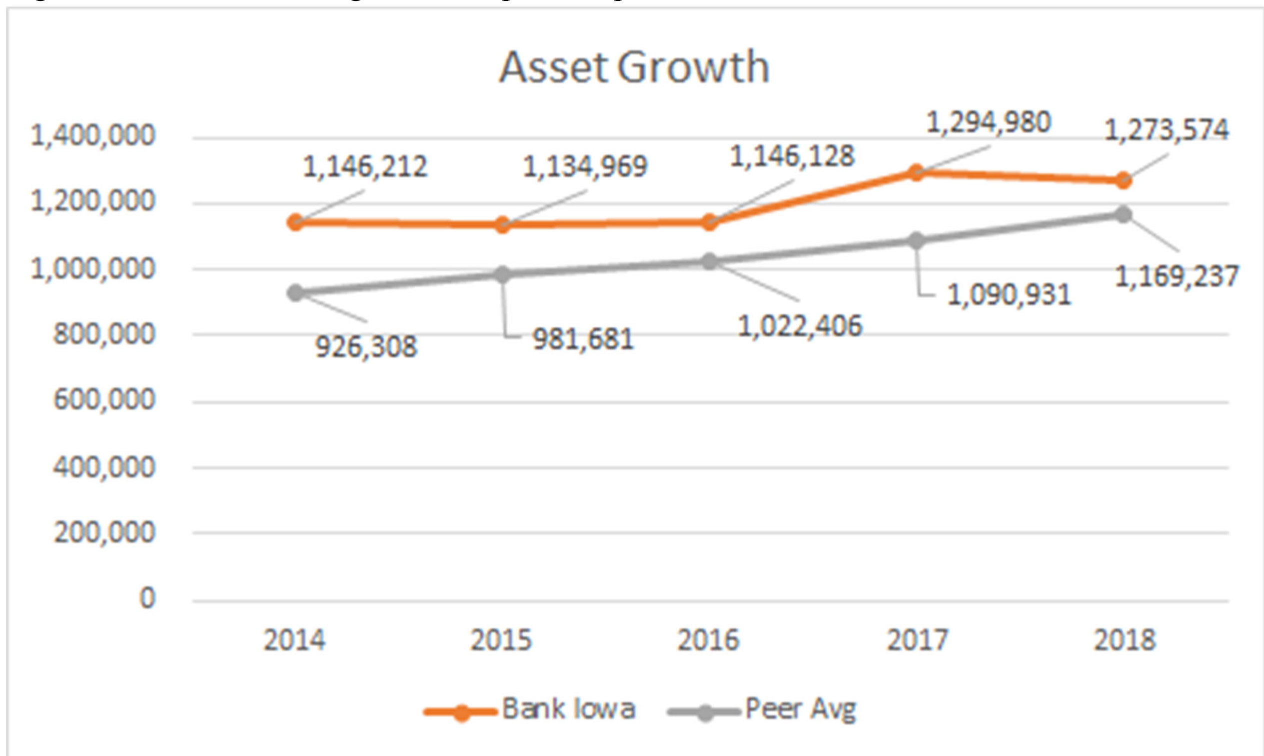


Figure 7: Bank Iowa capital ratio compared to peer Iowa banks, 2014-2018

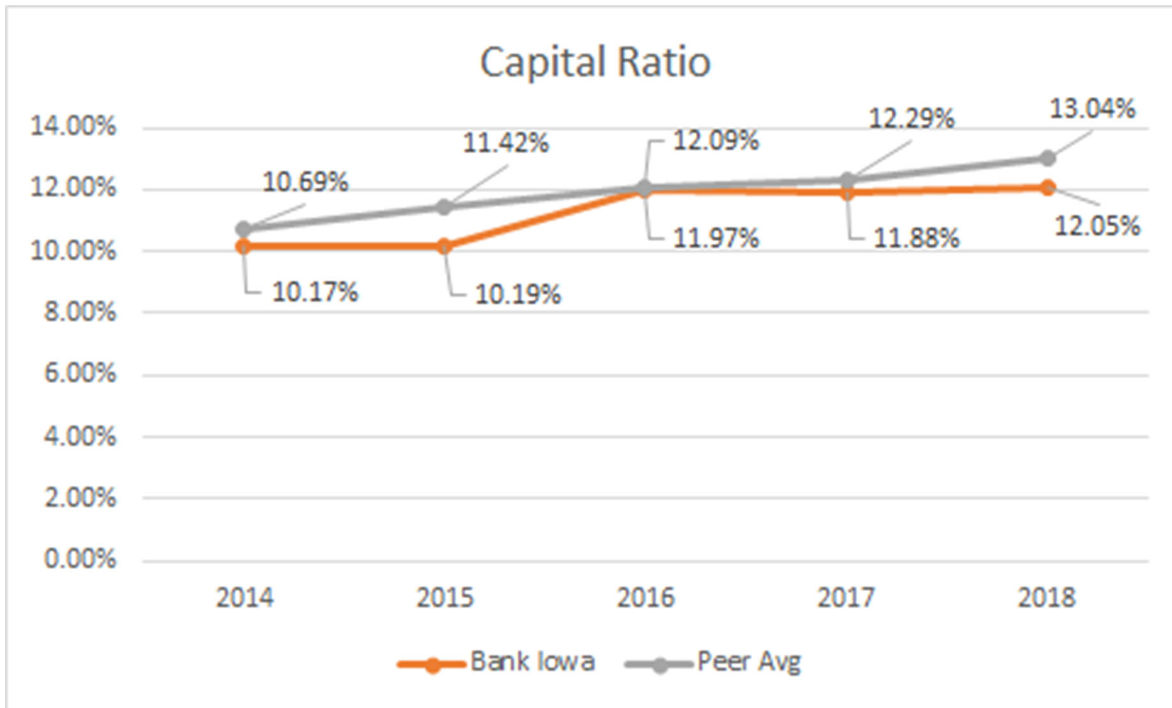


Figure 8: Bank Iowa liquidity compared to peer Iowa banks, 2014-2018

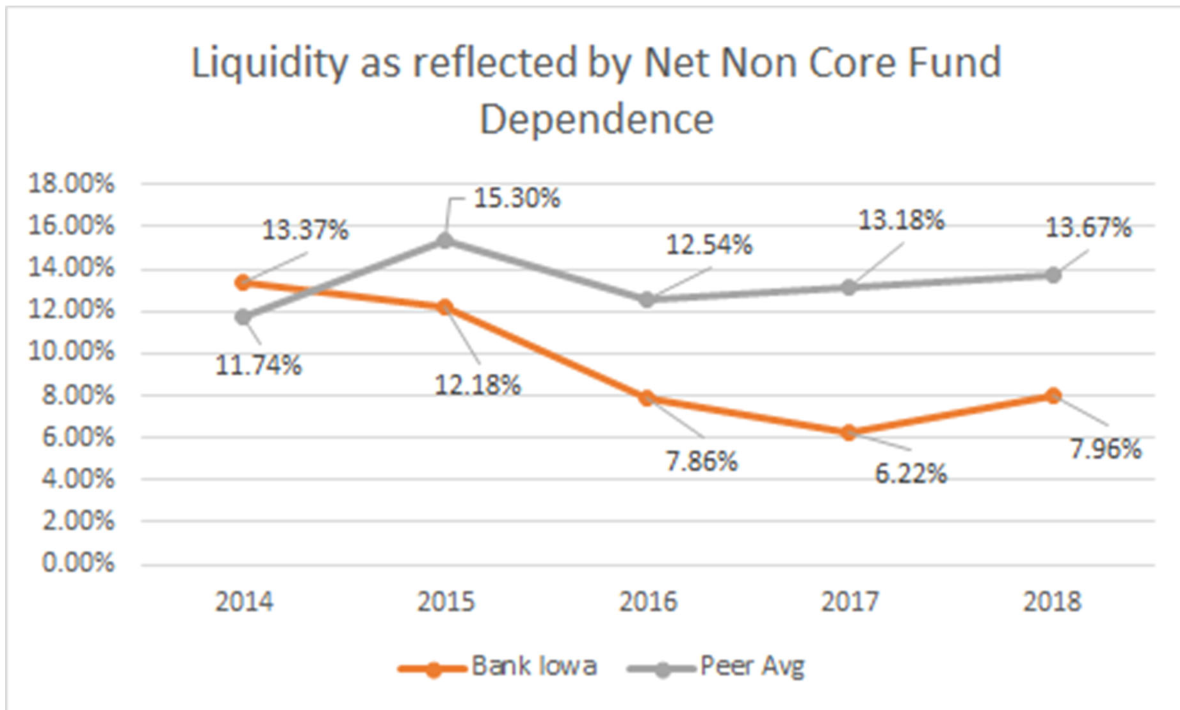


Figure 9: Bank Iowa liquidity relative to the Conference of State Bank Supervisors Minimum, 2014-2018

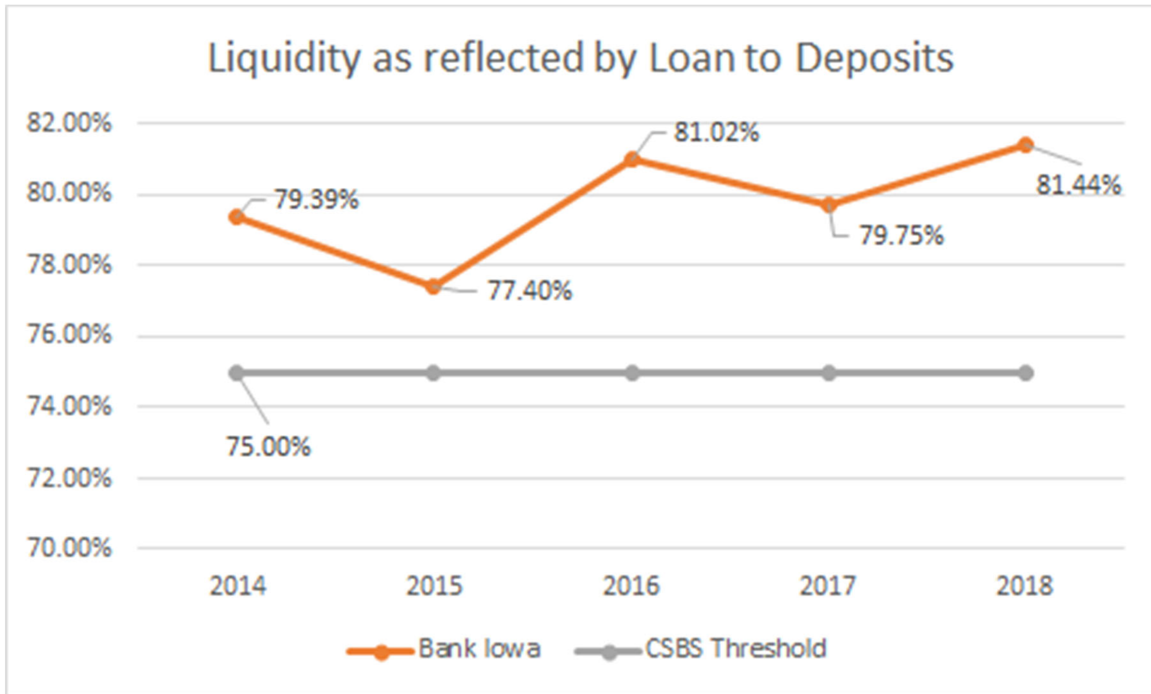


Figure 10: Bank Iowa efficiency ratios compared to peer Iowa banks, 2014-2018

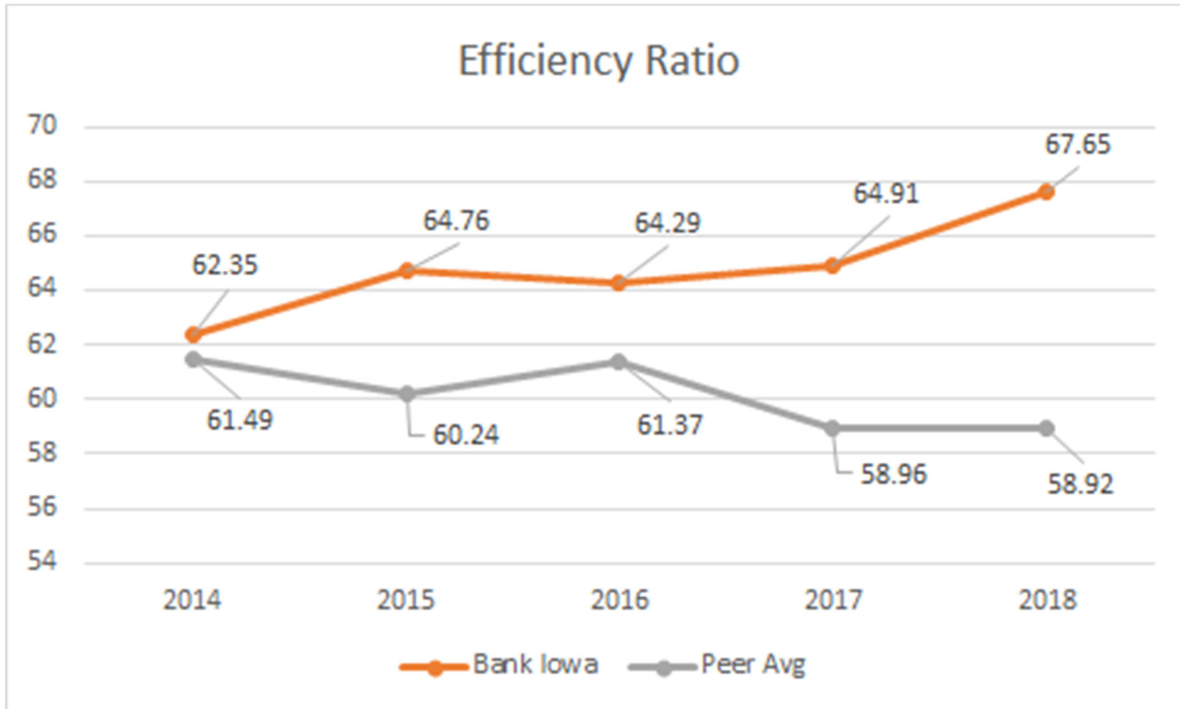


Table 2: Projection of Bank Iowa Assets, Income, Expenses and Efficiency Ratios, 2015 - 2023

	12/31/15	12/31/18	12/31/21	12/31/23	Growth
Total assets	1,134,969	1,273,574	1,813,350	2,295,022	1.802
Total equity capital	103,784	114,327	152,455	192,004	1.679
Total interest income	40,480	50,971	72,574	91,851	1.802
Total interest expense	5,805	9,320	13,270	16,795	1.802
Net interest income	34,675	41,651	59,304	75,056	1.802
Total noninterest income	4,996	6,420	9,138	11,565	1.801
Salaries and employee benefits	16,895	21,849	28,451	33,927	1.553
Premises and equipment expense	2,998	2,621	3,144	3,549	1.354
Additional noninterest expense	6,955	8,577	10,288	11,614	1.354
Total noninterest expense	26,848	33,047	41,883	49,090	1.485
Net income attributable to bank	10,572	13,780	24,420	34,628	2.513
Total Employees (full-time equivalent)	228	249	288	318	1.276
Salaries & Benefits / Employee	74.1	87.7	98.7	106.8	1.217
Net Interest Margin	3.06%	3.27%	3.27%	3.27%	1.000
Return on assets (ROA)	0.93%	1.07%	1.35%	1.51%	1.410
Return on equity (ROE)	10.23%	12.40%	16.02%	18.04%	1.454
Efficiency ratio	67.7%	68.8%	61.2%	56.7%	0.824
Assets per employee ($ millions)	4.98	5.11	6.29	7.22	1.413