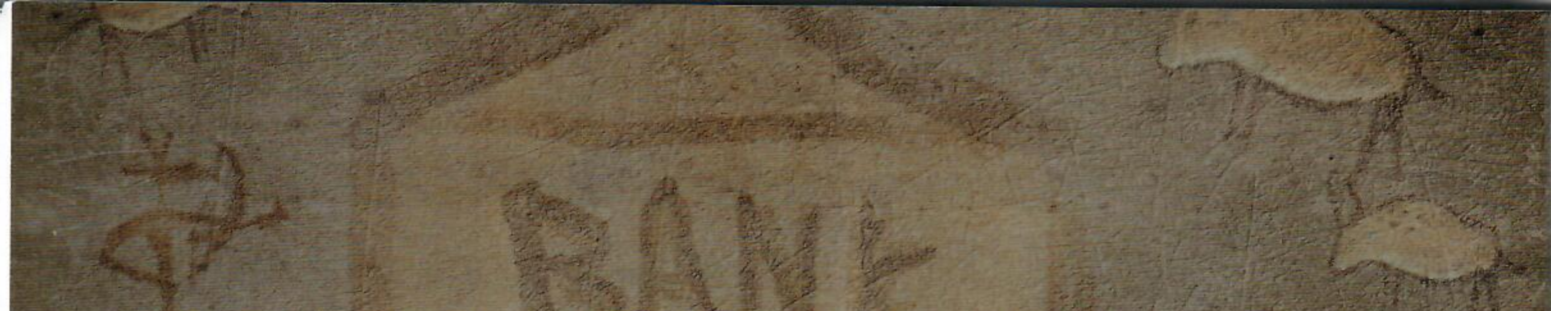


CUSTOMER BEHAVIOR *DRIVES* EVOLVING ROLE OF THE BANK BRANCH

COMMUNITY BANKS ARE RETOOLING THEIR BRANCH STRATEGIES TO ADOPT TO THE POST-COVID ERA

By Phil Davies

Last fall, while the Covid-19 pandemic raged across the country, Charter Bank of Eau Claire, Wis., bought a bank branch in Chetek, a resort community in northwestern Wisconsin. The $1.1 billion community bank saw opportunity in the area; during the pandemic visitors from Minneapolis and Chicago flocked to the small town and its surrounding lakes to recreate and buy property. Charter closed the deal with Bank First of Manitowoc, Wis., on Dec. 11, and three days later the branch opened as a Charter location, retaining its former Bank First deposits and employees.

With its Chetek purchase, Charter is betting that physical branches still have value after more than a year of severely restricted public access. Covid may have quickened customers' migration to online and mobile banking, but "we were convinced that there was still a need for some level of bricks and mortar — what we call presence," said Jeff Halloin, CEO of the bank's holding company, Charter Bankshares.

Bank owners are in the throes of rethinking their branch networks. This process has been ongoing for years, thanks largely to the rising popularity of digital banking, but the pandemic has brought the question of the future of branches into sharper focus. "What it has done is caused a serious reevaluation of what to do with a branch," said Jeffrey Gerrish of Gerrish Smith Tuck, a law firm and consultant to community banks based in Memphis, Tenn. "Do we keep it, sell it, reposition it?"

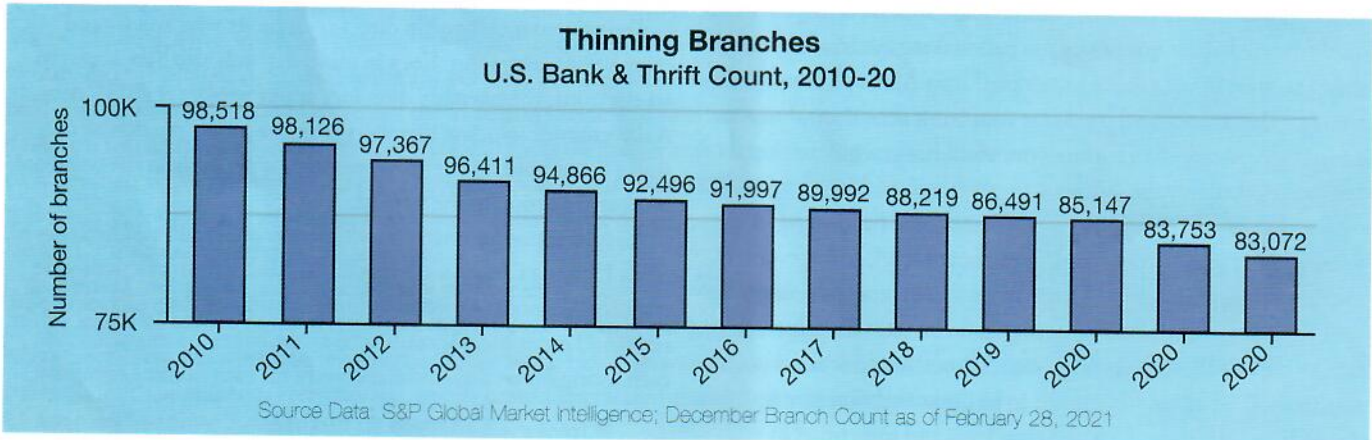
Aware that a substantial share of customers likely won't return to branches after Covid fears abate, community banks continue to invest in digital banking tools that kept them in business during the pandemic.

But small BHCs haven't abandoned the concept of the retail branch. While many large banks divest branches, most community banks are maintaining their branch networks — at least for now. Some are even expanding their presence in communities where they believe they have a competitive advantage. Community banks are also reassessing the services branches offer, staffing levels and the design of branches.

Hold 'em or fold 'em?

The death knell for branches has sounded often over the decades, initially when automated teller machines were introduced in the 1970s. Then came internet banking, followed by the smart phone, which empowered account holders to bank anywhere, anytime. With each innovation designed to eliminate the physical constraints of the branch (no waiting in teller lines!) branches survived; there has been no wholesale collapse of branch networks.

Instead, branches have gradually retrenched in the face of technological change. Over the past decade the number



of branches at banks and thrifts has fallen (see chart) as branch closings have outpaced openings. Branch attrition accelerated during the pandemic; the second half of 2020 saw a net loss of more than 2,000 branches nationwide, according to data compiled by the financial research firm S&P Global Market Intelligence.

The pandemic may have been a tipping point for big banks. Over the past year national and regional banks have sold or closed hundreds of branches, with no end to the culling in sight. PNC Bank is on track to close 120 branches this year, on top of the 160 locations it shuttered in 2020. Wells Fargo has announced plans to close 250 branches by year's end, and Truist Financial plans 800 closures by the first quarter of 2022.

Many large institutions have adopted a "thin branch" strategy, pruning locations outside core metro markets and relying on digital platforms to serve most customer needs. The way forward — whether to hold or fold branches — isn't as clear for BHCs; in large measure community banks derive their purpose from having a physical presence in communities, particularly those with few banking options, or poor Internet and cellular service that hampers online banking.

"They have this thing that you could call a conscience," Gerrish observed, "a moral compass that says, 'you know, we're the only bank in this town of 750 people. Can we really shut that branch down and keep our reputation as a community bank?'"

Jon Bruss, managing principal of Fortress Partners Capital Management, a strategic and capital planning advisor to community banks based in Hartland, Wis., notes that since the Great Recession community banks have "by and large not allowed their branch systems to get out of hand and have been trimming branches on a regular basis" to reduce costs. Many may be averse to further cuts.

Community bank leaders are taking different approaches to keeping branches relevant and profitable in the post-Covid era, informed by both the nature of the markets they serve and distinct visions of what it means to be a community bank.

Still committed to branches

Despite branch lockdowns, many community banks prospered during the pandemic. Demand for residential mortgages was strong, and applications to the federal government's Paycheck Protection Program poured in from beleaguered businesses. Banks that had developed digital services such as online deposit, bill pay and account opening before the pandemic experienced little disruption to their operations.

Many BHCs are leveraging their financial strength to pursue a two-pronged strategy: upping their virtual banking game while maintaining branch networks for customers they believe will return to branches when it feels safe to do so. Some banks have acquired locations from other financial institutions and even built *de novo* branches in key markets.

Charter Bank began investing heavily in digital platforms in 2015, hiring a chief information officer to oversee and upgrade an array of online and mobile banking tools. Halloin said they proved their worth in the pandemic, and the bank continues to make improvements and roll out new services. At the same time, the bank remains committed to its branch network, which includes two offices in suburban Minneapolis. During the pandemic customers frequently commented that they missed visiting their local branch, Halloin said. "Why this urge to come back? It was this need for connectivity beyond digital; they missed face-to-face contact with people."

That reaction to branch lockdowns was "an epiphany for us" that ratified Charter's commitment to branches, including its purchase of the Chetek branch, Halloin said. The bank is open to other opportunities to acquire branches — and whole banks — in its service area, although "we're going to be pretty selective," he said. "We want to make sure it's in our geography where we can serve those customers, and do so efficiently and profitably."

Horicon Bank, a $1.2 billion community bank with 19 locations in eastern Wisconsin, has also gone all-in on digital — in February it acquired a Georgia fintech firm to enhance its online and mobile platforms — while continuing to operate branches and develop new ones. "We still believe in branches as a sales function," said Senior Vice President Fred C. Schwertfeger. "That's where you engage with the community."

Sticking to an opportunistic growth strategy that has bought several new locations under the Horicon banner in recent years, the bank was planning to open two new branches in the Milwaukee metro area. Construction was underway this summer on a large new facility in the suburb of Wauwatosa, and a closed branch that Horicon acquired

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last year was scheduled to reopen by September in the outlying community of New Berlin.

When less is more

Nationwide, branch sales activity has declined since 2015, although the number of deals rebounded slightly in 2020, according to S&P Global. But market observers anticipate a resurgence over the next year or two as large banks continue to winnow their branch networks and more community banks seize opportunities to expand into promising exurban and rural markets. "In the future, partially as a result of the pandemic, community banks will be big players in the purchase of branches that come up for sale," Gerrish said.

However, not all community banks are interested in enlarging their branch footprint. Consolidation is the overarching national trend for all banks, not just big banks, observes Marci Malzahn, a Minneapolis-based management adviser to community banks and credit unions. Community banks are cutting branches on a smaller scale than big banks, but they too are striving to reduce costs in an industry being reshaped by virtual banking.

"The fewer branches you have the more efficient you will be," she said. "The question is, what is the ideal number of branches that you need to have in order to accomplish your strategic objectives?" For a community bank whose customers have embraced digital banking, it may not make sense to keep a branch in a small town a few miles away from another location.

BHCs that have sold or closed branch facilities in the past couple of years include Bank First Corp., and the Heritage Bancshares Group of Willmar, Minn. In addition to selling its Chetek branch to Charter, Bank First closed a branch in the small community of Weyauwega, Wis., earlier this year, citing increased use of online and mobile banking services as a contributing factor.

In late 2019, Heritage Bank sold six small-town branches in northwest Iowa, a move in line with its adoption of a "digital first" strategy over the past few years. Customers can conduct most bank business, including applying for mortgages and business loans, on their computers and mobile phones, says Heritage Bancshares CEO Tom Geiger. The bank has held onto its main Willmar location and six branches in Minnesota, Iowa and South Dakota, but has no plans to add branches "because we're seeing a lot of growth in the digital arena," he said. The bank's mortgage business has doubled in each of the past two years on the strength of online lending to customers in six states.

Beyond the teller line

Besides reevaluating the reach of their branch networks, bank leaders are also pondering how branches can best serve customers and generate profits in an increasingly virtual environment. Even before Covid sent over-the-counter transactions into freefall, teller transactions at community banks had fallen by about one-third since the early 2000s. "The more pertinent question that bankers will be answering is, what do our branches look like going forward?" said Anton Moch, a banking and finance attorney at the Winthrop & Weinstine law firm in Minneapolis.

Many community banks are exploring new formats and technologies intended to boost efficiency and foster higher-value customer relationships. Jason Howard, CEO of First State Bank and Trust in Bayport, Minn., knew what he wanted in a new branch facility under construction across the St. Croix River in Hudson, Wis. Or rather, what he didn't want: "... somebody to walk in and the first thing they see is a big old teller line. We obviously have to conduct transactions like that, but they're not as common."

The branch's open layout — a hot trend in branch design — includes fewer, less obtrusive teller stations and four large conference rooms set up for video calling. A designated "concierge" will direct visitors to trust, commercial banking and other First State business units. "Eighty percent of the people who walk into our building won't be doing a teller transaction; they'll be there for something else," Howard said.

Following the lead of large banks, some community banks have installed interactive teller machines (ITMs) in their new or remodeled branches. Combining the convenience of the ATM with the personal touch of video calling, ITMs let customers talk face-to-face with an onscreen teller serving multiple branches from a central location. Horicon Bank was planning to set up ITMs in drive-throughs at its new Milwaukee-area locations and at several smaller branches as they're remodeled.

These innovations in the form and function of branches go hand in hand with a drive by community banks over the past decade to deploy a leaner, smarter retail workforce. Tellers are evolving into "universal bankers" trained to provide higher level services such as opening a deposit account or processing an auto loan. "Banks are reducing the staff of their branches, and giving them more responsibilities," Malzahn said, adding that the drastic drop in foot traffic during the pandemic has accelerated this transition to lighter-staffed branches.

As BHCs mull the future of the branch in the wake of the pandemic one thing is for sure: the ground will keep shifting under branches as digital increasingly becomes the way banking is done. But brick and mortar is likely to remain central to the identity of community banks, especially in small communities. The challenge for bank leaders is to strike the right balance between virtual and physical.

In this regard Bruss of Fortress sees a silver lining in the pandemic; working at home while bank offices were closed gave bankers a chance to "sit back and think about what they've done, and how they could perhaps do it better. I think the pandemic has been a boon to community banks." ■

Freelance economics and business writer Phil Davies is a former editor with the Federal Reserve Bank of Minneapolis.