FORTReSS PARTNERS

E-Memo

TO: INVESTOR/MEMBERS, BANKERS AND FRIENDS
FROM: Jon Bruss
DATE: May-June 2022
SUBJECT: Stopping a Train Wreck

Near the end of 2020 we began to write what we hoped would be our New Year 2021 *E*-Memo. We never got to finish it because your writer managed to tear most of what remained of his right rotator cuff. In early Spring of 2021 being able to type was promised by my orthopedic surgeon who was able to schedule me for a reverse should replacement. The shoulder has mended sufficiently to allow typing and production of the Fortress *E*-Memo. Moreover, we have been reminded several times over the last year that there are a number of you who read this modest publication and have missed it so here goes—again!

Geopolitcal concerns along with machinations of the Federal Reserve System eclipsed the financial results of community banks nationwide and in the portfolio of community banks we manage. All in all, the banks in our portfolio—both publicly traded and privately held—reported solid results for the quarter ended March 31, 2022. But, as you know, their share values were adversely impacted by the decline in the broader markets. The NASDAQ Bank Index of over 300 banks, many of which are community banks, declined by **-16%** from January 3 to May 25, 2022. (Our Fund declined **-5%** during that same period.)

While we believe credit conditions and capital ratios remain well within the confines of acceptability for investors, bankers and regulators, other matters are garnering the attention of bank executives:

- Declining loan growth and net interest margin (NIM) pressure
- Inflation and interest rate volatility
- AOCI—accumulated other losses on investments classified as AFS—available for sale
- Declining mortgage banking activity
- Actively managing oversized levels of cash and investments while avoiding the twin risks of interest rates and duration

Of the foregoing five challenges facing bank managers today, we believe the decline in loan growth and pressure on NIM are serious, major challenges facing community banks today.

Bank advisors Paramount Financial Technologies (PFT) recently released an article on the "Disappearing Commercial Banker" calling it a "train wreck 15 years in the making." We have also bemoaned the disappearance of commercial bankers through complacency in credit and management training and lack of creativity in identifying talent.

Our former colleague, Scott McCallum, and I commiserated more than once about the disappearance of Rotational Management Training Programs in commercial banks. Our industry has indeed sown the seeds of its own demise with the elimation of management and credit training programs, inflexible organizational structures and the inability to transition from commercial real estate (CRE) lending to more commercial business banking.

Back in the day—for us, 40+ years ago—we were expected to be effective and proficient developing new business, credit analysis and underwriting, and the management of the resulting portfolio. Where does one find men and women like that today to balance the three somewhat discrete skill sets? Increasingly, its tough to find folks like that "on the street"—something your HR manager could quickly tell you. And, finding talent like that on the street can be very expensive and culturally disruptive.

As a result, many community banks, especially those with $1 billion plus in assets are "building their own." One of the internal building blocks we've seen used effectively is to identify successful retail banking customer service representatives. They can be developed into successful business development officers because they are good listeners, have good technical skills and are good at following through. We don't know of a bank customer or prospect who wouldn't want to deal with someone with those skills!

We don't have to deal with this commercial banker train wreck if we focus on building our own—the old fashioned way by identifying men and women in the ranks whose skill set will carry them along to successful business development roles, credit underwriting and portfolio management, and avoiding the silos large banks love to create around those three functions. We can also find a way to create a formal rotational management training program to attract young men and women into the business of banking.

If we don't pay attention to the talent in our organization with the right skill sets or create that rotational management training program we will indeed be a part of that commercial banker train wreck which has opened the door to competition from fintechs and neobanks.

I don't want to be a part of that, do you?

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