

INSTITUTIONAL CAPABILITIES AND
ENTREPRENEURIAL ADVANTAGE: BRIDGING THE
GAP BETWEEN REGULATORY MANAGEMENT AND
OPPORTUNITY

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Abstract: Firms are increasingly using tactics to manipulate their regulatory constraints, while at the same time regulatory environments are becoming increasingly complex and dynamic. Although scholars have described many of the activities firms use to change their institutional environments, this research has largely examined the manipulation and creation of informal institutions, such as organizational forms or social customs or traditions. We have much less understanding about 1) what drives firms to manipulate formal, regulatory institutions, and 2) why firms might differ in their abilities to create institutional change. This dissertation addresses these issues by linking regulatory constraint manipulation to entrepreneurial outcomes – specifically, the pursuit of valuable business opportunities – and it proposes that firms may develop institutional capabilities, which enable them to pursue competitive advantage strategies that rely considerably on institutional manipulation.

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CHAPTER 1 INTRODUCTION

A wide array of legal statutes, regulations, codes, laws, and constitutions constrain the objectives organizations may pursue and how they pursue them, and when these constraints are violated by an organization, the organization, its employees and its leaders may face punitive measures, including fines or prison sentences. While organizations retain a great deal of discretion in setting and pursuing objectives, many of their activities are nevertheless closely monitored and constrained by the proscriptions of national, state, and local governments (Edelman & Suchman, 1997; Laeven & Levine, 2009). Some industries, such as defense contracting, nuclear energy production, banking and finance, and healthcare, are heavily regulated and subject to multiple levels of regulations, which are often produced and enforced by government agencies specifically created to monitor a particular industry. For example, hospitals are constrained by regulations from several federal-level agencies, such as the Department of Health and Human Services and the Food and Drug Administration, as well as state- and local-level agencies. Even organizations in lightly regulated environments are still subject to complex, federal- and state-level proscriptions regarding how they hire, pay and fire employees, how they maintain workplace safety, and even how they build their buildings and install wiring, hot water tanks, and other hardware. Table 1 provides many more examples of industries and agencies that regulate them.

Please see Table 1

These regulatory constraints, which are a type of formal institution (e.g., North, 1990; Scott, 2001), constitute a critical part of the broader mosaic of the “rules of the game” that constrain the behavior of all individuals and organizations within society.¹ Formal institutions are codified and enforceable constraints, which range from unwritten contracts to the written constitutions of states and nations. Organizations are compelled to obey formal institutions because they are enforced through the coercive power of the legal entities of state (Ostrom, 1986). Informal institutions may also be defined as constraints in that they limit the range of behavior that may characterize social interactions between actors. However, in contrast with formal institutions, informal institutions are not explicit or codified, they are not usually enforced through coercion, and they are less malleable than formal institutions because they are the outcome of generations’ worth of past interactions (North, 1990).

Entrepreneurs, who uncover and exploit opportunities to create customer value through introducing innovative products and services (Choi, Levesque, & Shepherd, 2008; Shane & Venkataraman, 2000; Shane, 2012) are constrained by extensive and complex regulatory environments. Regulations shape the environment in which entrepreneurs are embedded and influence the variety of opportunities entrepreneurs may uncover as well as limit their means of exploitation (Baumol, 1990; Meek, Pacheco, & York, 2010; Shane, 1993). Consider, for example, the opportunity to manufacture and sell roulette machines to casinos. Such an opportunity exists in Oklahoma for roulette machine manufacturers while it does not in Texas,

¹ North (1990) draws sharp contrast between institutions, which he refers to as the “rules of the game,” and organizations. He writes: “what must be clearly differentiated are the rules from the players.” This dissertation takes into consideration both regulation and regulatory agencies; therefore, to avoid confounding both as “institutions,” I adopt herein a strict adherence to North’s definition of institutions as constraints on individual and organizational behavior, which are distinct from the organizations that create them. In other words, a regulation, law, or statute may be an institution, while an agency, political body, social movement, or any other organization are not institutions. Furthermore, to maintain this conceptual clarity for myself and for the reader, I will refer to institutions primarily by their function; hence, constraints, proscriptions, restraints or limits.

which is an outcome of the difference between regulatory environments across both states. Or consider the example of the front-yard lemonade stand. While the opportunity to have such a stand is not prohibited, entrepreneurs hoping to exploit the opportunity must first obtain licenses for food handling or risk being shut down.

While organizations may accept, acquiesce, and conform to their regulatory environments (Meyer & Rowan, 1977; Zucker, 1987), organizations that encounter constraints that are especially burdensome or costly may be more likely to attempt to alter their regulatory environments (Oliver, 1991; Seo & Creed, 2002). Scholars have increasingly examined the relationship between firms and their regulatory or broader institutional environments. Institutional theorists have described the strategic approaches firms may adopt in relation to their institutional constraints, such as attempting to avoid, manipulate, or defy these constraints (e.g., Oliver, 1991; Zimmerman & Zeitz, 2002). Under the aegides of institutional entrepreneurship and corporate political activity, scholars have also cataloged the various tactics firms and other actors use to manipulate institutions or to create new ones (e.g., Lawrence & Suddaby, 2006; Pacheco, York, Dean, Sarasvathy, 2010; Hillman, Keim, & Schuler, 2004). These tactics include a wide range of activities, including simple political advocacy to more complex activities such as framing and social movement organization. Scholars have also described the means through which these activities take place, especially the role discourse (i.e., spoken or written interactions) plays in creating and maintaining new or altered institutions (e.g., Lawrence & Phillips, 2004). And finally, scholars, in attempting to address the paradox constituted by the notion of constrained actors altering their constraints (Garud, Hardy, & Maguire, 2007; Leca & Naccache, 2006), have attempted to describe the conditions under which actors may nevertheless escape their restraints to effect change, such as the existence of conflicting or contradictory

constraints (e.g., Battilana, Leca, & Boxenbaum, 2009; Greenwood & Suddaby, 2006; Maguire, Hardy, & Lawrence, 2004), and the resources deployed by these actors, such as power and knowledge (e.g., Kahn, Munir, & Willmott, 2007; Levy & Scully, 2007).

Although past research has made notable progress regarding the tactics and strategies organizations may use to alter their institutional environments, scholars have largely examined issues related to the neoinstitutionalism of DiMaggio and Powell (1983) and have therefore focused on explaining how new forms of organizations are created and institutionalized and how actors may surmount institutional pressures to effect this type of change. We have much less understanding regarding why and how already-established firms may pursue institutional change as a central component of obtaining and sustaining competitive advantage and why some firms may be better at wielding such influence than others. More specifically, no framework yet exists that describes firms' routine activities to interact with and manipulate legal regulatory constraints and the role these routine activities play in facilitating regulatory change, despite scholars' suggestion that such routine activities may be vital to firm performance (Bagley, 2008, 2010). In addition, the links between these routines and entrepreneurial outcomes, such as opportunity identification and exploitation, have not yet been established.

This dissertation tells the story of why and how firms may pursue the core entrepreneurial functions of opportunity identification and exploitation through developing capabilities to interact with and manipulate the legal regulatory institutions that constrain them. To tell this story, this dissertation integrates institutional theory, especially institutional entrepreneurship research, and organizational capabilities perspective. Institutional theory (DiMaggio & Powell, 1983; North, 1990; Scott, 2001) concerns the relationship between formal and informal constraints and organizations' behavior. Organizational capabilities perspective (Barney &

Ariken, 2001; Nelson & Winter, 1983; Winter, 2003) suggests that firms may develop routines related to producing products and services and that these routines may be a central component constituting firms' ability to achieve lasting, above-average performance.

This is an important story to tell for two practical reasons and for several theoretical reasons. First, some industries are experiencing rapidly changing formal institutional environments and are coming under greater levels of regulatory control (e.g., Bargeron, Lehn, & Zutter, 2010). Understanding how firms successfully encounter such changes and even stymie regulatory changes may be an important tool for firms should some regulatory environments continue to exhibit considerable dynamism. Second, some firms are achieving greater levels of success due to their ability to interact with and manage their institutional environments (Lux, Crook, & Woehrer, 2011). These trends suggest that firms are deliberately interacting with the formal institutions that regulate them as an important means for attaining sustainable competitive advantage. Understanding how and why these firms are pursuing these routine activities may establish a foundation of knowledge with which other firms may foster and deploy such routines. This dissertation intends to make several contributions to institutional theory and organizational capabilities perspective. As mentioned above, many of the strategies and tactics used by organizations to manipulate their institutional environments have been catalogued and explained. This dissertation complements existing theory synthesizing extant research on institutional entrepreneurship and capabilities into a cohesive framework that explains the role and importance of institutional capabilities, which are directed at interacting with and manipulating formal institutions. For example, while Oliver (1991) described several strategic postures firms may adopt regarding institutions, little research has explained *why* firms may be predisposed to assuming one posture over the other – the existence of institutional capabilities may inform this

choice. Institutional capabilities may also inform the debate on the paradox of embedded agency: for instance, firms that have developed certain routines may be more likely to manipulate institutions, regardless of the constraints they encounter. For organizational capabilities perspective, this dissertation will contribute to the growing literature regarding specific types of capabilities firms may deploy to obtain competitive advantage. While some scholars have begun moving toward integrating the capabilities perspective with institutional theory (e.g., Bagley, 2008; Oliver & Holzinger, 2008; Crane, 2013), this research has not specifically conceptualized institutional capabilities nor synthesized existing research regarding the activities important for developing and deploying these capabilities (e.g., Hillman et al., 2004). Finally, this dissertation contributes to a greater understanding of *why* firms may use capabilities to interact with and manipulate their institutional environments. The framework presented in this dissertation relies on concepts and relationships established within individual-opportunity nexus perspective within entrepreneurship theory (i.e., opportunity and innovation) (Eckhardt & Shane, 2003; Shane & Venkataraman, 2000; Short et al., 2010) as the central impetus of institutional capabilities. In other words, these capabilities, though directed at changing firms' institutional environments, are used to capture a greater number of more valuable business opportunities.

The two research questions motivating this dissertation are 1) why do firms opt to manipulate their regulatory environments as a competitive strategy, and 2) what role do institutional capabilities play in facilitating their pursuit of this strategy? To address these questions, this research will employ a mixed, qualitative-quantitative method and examine the activities, regulatory environments, and entrepreneurial performance of commercial banks throughout the United States. The qualitative, interview portion of the study will help establish a stronger conceptualization of the concepts and relationships presented in the next two chapters.

The quantitative, survey-based portion of the study will establish the nature of the relationships between firms' possession of institutional capabilities and their entrepreneurial performance.

CHAPTER 2 LITERATURE REVIEW

This chapter will outline the concepts and relationships described by institutional theory and organizational capabilities perspective. As this dissertation explains how organizations seek to interact with and change regulatory constraints, which are a type of institution, it will first be necessary to define and describe institutions more broadly in their various types, describe how institutions compel organizations to conform to their expectations, describe the particular characteristics of regulatory institutions, describe how institutions change, and, finally, describe how organizations may influence and alter institutions through institutional entrepreneurship. The second section of this chapter will describe organizational capabilities generally and lay the foundation for institutional capabilities, which are a significant component of Chapter 3.

INSTITUTIONAL THEORY

Describing institutions: definitions and types. Institutions are behavioral constraints that guide and influence individual and organizational behavior (North, 1990; Scott, 2001). Institutions exist in a variety of forms, such as social taboos, customs, traditions, rules, laws, and constitutions. Individuals and organizations tend to conform to institutions in order to obtain social approval, or legitimacy, which enables them to subsequently acquire other important resources (Suchman, 1995; Zimmerman & Zeitz, 2002). Individuals and organizations also conform to institutions to reduce behavioral uncertainty. Research describes how institutions may constrain and *enable* behavior, by providing time-tested patterns of interaction, which actors may call up in new situations (DiMaggio & Powell, 1983; Jepperson, 1991). Finally, individuals

and organizations conform to institutions to avoid sanction or punishment, especially where institutions are enforced through coercive, governmental power (Scott, 2001).

Institutions are typically categorized into formal and informal types (North, 1990). Informal institutions are constraints erected by non-governmental social entities, such as the tacit rules perpetuated by culture, social tradition, and language. Informal institutions constrain behavior: consider, for example, the difference between rules guiding gender interactions in the United States and in Egypt. Behavior customary in one country may not be socially acceptable in the other. Organizations that do not conform to informal institutions are usually subject to social sanction and the loss of legitimacy (Scott, 2001). Informal institutions may also enable behavior. In this sense, institutions may act as routines, customs, and guidelines for how to act in any given situation (Gioia & Poole, 1984). These institutions, while fundamentally constraints, also equip actors with the ability to act appropriately (Barley & Tolbert, 1997; Schutz, 1967). The use of language is an appropriate example. While language contains certain constraints, such as grammar and usage rules, communication itself would not be possible without language. Furthermore, the select use of sayings and idioms characteristic of a particular culture or region can help users garner social legitimacy: consider the southern politician who speaks without an accent while in Washington, D.C., while amplifying her accent in her home constituency. In addition, informal institutions also include cognitive constraints (Scott, 2001). Cognitive constraints include routine patterns of thought that individuals develop over time through repeated social interactions (Giddens, 1984; Weick, 1995).

In contrast to informal institutions, formal institutions usually are explicit constraints constituted by written laws, rules, regulations, and constitutions. They also include contracts and property rights, which are frequently unwritten (North, 1990). Similar to informal institutions,

formal institutions are fundamentally constraints, but they may also facilitate some forms of behavior that would otherwise be impossible. Formal institutions constrain behavior: consider, for example, traffic laws, which specify the maximum speeds people can drive on public roads, or zoning regulations, which prohibit certain types of buildings from being constructed without government permission. As opposed to informal institution, which are enforced through social sanction and loss of legitimacy, formal institutions are enforced through coercive means (Scott, 2001), and specific punishments, fines, and other sanctions are attached to types of constraint violations. While fundamentally behavioral constraints, formal institutions may also enable behavior. For example, contracting allows two or more parties to enter into a business agreement, which they might not otherwise do in the absence of enforceable contracts and the possibility of opportunism (North, 1990). Also, certain constitutional rights guarantee that people are free to behave in certain ways, such as the First Amendment's right to free religious association. However, formal institutions are able to enable behavior due to the likelihood of coercive enforcement (Ostrom, 1986): contracting would be pointless without an independent third party (i.e., the government) ensuring contracts were fulfilled (North, 1990), and the First Amendment successfully enables free religious association by *constraining* other types of behavior (i.e., specifically, governmental action; the amendment is clearly framed as a constraint: "Congress shall pass no law ...").

Institutions do not always fall squarely into informal or formal categories. North (1990) suggests instead that institutions lie along a continuum, from the most informal (e.g., cognitive patterns of thought and cultural norms) to the most formal (e.g., vigorously enforced federal or state regulations and codes of law). It may be possible that some institutions possess informal characteristics and formal characteristics. Table 2 presents an institutional continuum and

provides examples. For example, legal tradition allows for spoken, tacit agreements between two individuals to be enforced as contracts; another example might include churches that have highly developed codes of canon law, such as the Roman Catholic or Orthodox churches; yet another example might include regulations that are written with a particular intent but enforced with another. Each of these examples contain mixes of formal (i.e., written, codified, or coercively enforced) characteristics and informal (i.e., tacit, value/norm-based, unwritten) characteristics.

Please see Table 2

Before moving to the next section, two other issues remain to be discussed regarding characteristics of institutions. First, enforcement is a critical component of any institution. While formal institutions, especially regulatory institutions, are often predicated on written rules and policy, not all written rules and policies constitute institutions. Written rules or policies that are unenforced or weakly enforced are ineffective at constraining behavior and may not be considered institutions at all (Ostrom, 1986). Enforcement takes several forms, which are also presented in Table 3 based on DiMaggio and Powell's (1983) typology. DiMaggio and Powell (1983) describe three types of enforcement, which they call isomorphism: coercive isomorphism, or the compulsion through force (e.g., usually legal, such as state police power or regulatory supervision); mimetic isomorphism, or mimicry meant to surmount uncertainty (e.g., organizations in highly dynamic or uncertain environments may attempt to copy the behaviors of similar organizations); and normative isomorphism, which is the outcome of high professionalization (e.g., firms that employ high numbers of certified public accountants or registered nurses or college professors tend to conform to certain constraints placed by the professions themselves).

Please see Table 3

The second remaining issue important for this discussion is distinguishing institutions from other concepts, which, through scholarly usage, have also come to be considered institutions. This dissertation strictly follows North (1990) and Scott (2001), who argue that institutions are constraints on individual or organizational behavior and are distinct from organizations. Given the work of leading current institutional theorists, such a statement seems to contradict the current conceptualization of institutions. For instance, Greenwood and Suddaby's (2006) work on new forms of accounting firms describes the formation of new organizations as does Maguire et al.'s (2004) description of the emergence of HIV/Aids advocacy groups in Canada. Table 5, which is presented later in this chapter, lists examples of institutional entrepreneurship published from 2000, and the majority of these articles discuss institutions as either organizations, social practices, or other types of recurrent routines.

Elsewhere, such as in developing economies literature, institutions may also refer to the infrastructure of society. Such infrastructure is commonly understood to include property rights, which North (1990) recognizes as an important formal institution, but it may also include roads, utilities, and access to banking services (e.g., Webb, Kistruck, Ireland, & Ketchen, 2010). While roads and utilities are not institutions in the strictest form of the definition used in this dissertation, infrastructure nevertheless has characteristics that resemble institutions, insofar as they constrain behavior, and they may be considered the means of institutions. For instance, roads may be seen as establishing the preferred market priorities of a country: cities connected by roads are freer to trade than those not connected. That such connections are usually the outcomes of political decisions suggests that roads themselves may be used as a tool to enforce

approved travel and trading patterns. Table 4 attempts to parse out and distinguish the three concepts: organizations, institutions, and means. For example, a family is a type of *organization* that is characterized by certain *institutions* (e.g., such as patriarchy, motherhood, generational respect, etc.), and that uses certain *means* to establish and maintain these institutions (e.g., living conditions within the home, decisions regarding who goes to school, and other, more serious tactics, such as female circumcision).

Please see Table 4

This broadening of the definition of institution is likely an outcome of DiMaggio and Powell's (1983) paper and later work that suggests successful organizations can influence the behavior of other, less successful organizations through mimetic isomorphism. This trend may also be a result of the recognition that organizations and routines themselves are fundamentally sets of constraints, or the physical manifestations of shared cognitive institutions (e.g., Weick, 1995). Nevertheless, this dissertation strictly adheres to the conceptualization of institutions as constraints, in an effort to avoid conceptual murkiness and present a clearer argument.

What institutions do. As mentioned earlier, isomorphism is the mechanism through which institutions wield their power over organizations. Specifically, isomorphism is defined as a “constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions” (DiMaggio & Powell, 1983: 149). Institutional theory presents isomorphism as the mechanism responsible for creating so many similar organizations – organizations within the same environments tend to conform to the same sets of institutional pressures and behave within similar constraints; therefore, such organizations tend to resemble each other over time (Hannan & Freeman, 1977; Meyer & Rowan, 1977). The three types of

isomorphism were described above: coercive, mimetic, and normative (DiMaggio & Powell, 1983).

Although isomorphism is a powerful force, institutions may nevertheless be ignored without an added inducement to conform: legitimacy. Legitimacy is the “generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions” (Suchman, 1995: 574). Organizations derive legitimacy when they conform to institutional expectations (Scott, 2001). As Zimmerman and Zeitz note, “legitimacy is a *relationship* between the practices and utterances of the organization and those that are contained within, approved of, and enforced by the social system in which the organization exists” (2002: 416). In other words, an organization may be characterized as legitimate when it appears to behave in ways that are congruent with how institutions define appropriate behavior.

Organizations conform to institutions to acquire legitimacy, but legitimacy itself is not the goal. Organizations desire to survive, and with legitimacy, they are able to unlock access to other resources, such as human capital, financial capital, social capital and technology (Aldrich & Fiol, 1994; Hannan & Freeman, 1989). Legitimacy is particularly relevant to new or innovative organizations, which tend to first demonstrate institutional conformity before ultimately achieving growth (Zimmerman & Zeitz, 2002).

How institutions change: gradual, non-purposive. There are two broad processes through which institutions change. The first process is gradual, non-purposive (i.e., social actors are not seeking to achieve deliberate change outcomes), and it is based on very broad shifts in social characteristics, such as demographics (Oliver, 1992; Phillips, Lawrence, & Hardy, 2004; Scott, 1987). Generally, this process occurs through the perpetual acquisition and use (or revision) of

scripts. Scripts are the fundamental constitutive units of institutions and are defined as “observable, recurrent activities and patterns of interaction characteristic of a particular setting” (Barley & Tolbert, 1997: 98). Individuals and organizations acquire scripts through interacting with others and store them in their memories or written records to use again (Gioia & Poole, 1984; Phillips et al., 2004). Scripts create efficiencies in interaction: individuals and organizations can rely on and trust scripts to appropriately guide their behavior with other actors (Chiasson & Saunders, 2005). Alternatively, without scripts, actors would necessarily have to devise new ways of interacting with each subsequent interaction, which takes more time and risks error. Many institutions exist in the balance between cost and efficiency (North, 1990). Insofar as institutions are efficient – and reduce costs – they will likely persist. However, when institutions create more cost than efficiency, they may be subject to change. However, actors may occasionally revise scripts, through accident or purposeful innovation. Sometimes, these innovations may prove to be more useful than those that already exist, and others will adopt them. The degree to which new scripts are adopted across a set of actors equals the degree of institutionalization. Practices change over time, whether it is in the adoption of business planning at non-profit museums (Oakes, Townley, & Cooper, 1998), individuals’ collective recognition that a multinational Europe is emerging (Sweet, Sandholtz, & Fligstein, 2001), or the dissemination of total quality management practices across U.S. hospitals (Westphal, Gulati, & Shortell, 1997).

This first process of change is connected to the widespread rejection or adoption of scripts. Informal institutions may be particularly susceptible to this first process of change: as informal institutions are taken-for-granted and largely self-enforced, individuals may be less likely to deliberately target these sorts of institutions either because they are not aware they exist

or because their widespread social acceptance makes them very hard targets to change. The most current fashion trends, traditional or cultural rituals (e.g., shaking hands), and dialect are examples of such institutions. In contrast to informal institutions, formal institutions are less taken-for-granted, frequently enforced by independent third-parties, and frequently only regulate small portions of society; therefore, they are much more likely to be altered through the second process of change, or deliberate change, which I will describe next. However, formal institutions, even regulatory institutions, may be susceptible to this first process of change. For example, broad-based social trends frequently have a profound, if delayed, influence on formal institutions. The constitutional amendments banning slavery occurred only after a decades-long abolitionist effort, the creation and election of an abolitionist party, and finally a civil war. Further evidence of this gradual, unintentional change process may be found in the numerous unenforced, outdated laws that hide in city and state codebooks, recalling that unenforced laws lack the constraining power of institutions (Ostrom, 1986). Many states still regulate how horse-drawn carriages should be driven and parked, or regulate the particulars of the relationships between two men, or set the rules of how U.S. senators are appointed (i.e., the normal course of senatorial representation was established by appointment in the 19th century).

How institutions change: quickly, with deliberate action. Institutions may also be changed through a second process, referred to as institutional entrepreneurship. Institutional entrepreneurs are individuals (or organizations) that seek institutional change in order to obtain some sort of favorable outcome (Garud, Jain, & Kumaraswamy, 2002). Institutional entrepreneurs engage in various behaviors to obtain the change they desire, such as by building social movements (e.g., Fligstein, 1997) and reframing old issues in new and different ways to generate public support (e.g., Rao, 1998).

Actors are willing to conform to institutional constraints because doing so can help the actor acquire legitimacy. However, conformity can also create inefficiencies as actors divert time, attention, and money away from more value-productive activities in order to meet institutional expectations (Oliver, 1991; Zimmerman & Zeitz, 2002). In addition to creating inefficiencies, institutions can also perpetuate hierarchy structures, to the benefit of some actors and at the expense of other actors. For example, in apartheid South Africa, some businesses were severely disadvantaged by laws that placed limits on non-white citizens while white-owned businesses benefited from the shackles placed on their potential competition. Hierarchy structures tend to limit access to resources, favoring those with status and constraining those without status (Bourdieu, 1990; Lawrence, 1999). Therefore, some actors may be motivated to alter institutions where the costs of conformity to an institution are too high or where an institution perpetuates an unequal hierarchy (e.g., Maguire, Hardy, & Lawrence, 2004).

Much of the debate within institutional entrepreneurship has concerned the paradox of embedded agency – that is, how do actors who are embedded within institutions and are, in many cases, required to conform to these institutions, affect institutional change? Some scholars have criticized the notion of the institutional entrepreneur and suggested that their role in institutional change has been exaggerated (Delmestri, 2006; Meyer, 2006); others argue that the notion of institutional change agents is incongruent with institutional theory and may require the use of other theoretical perspectives (Suddaby, 2010). This position is contrasted with research, including that conducted by scholars foundational to institutional theory, that suggests that individuals may play a vital role in changing institutions. Max Weber, whose research describing the development of Western-style bureaucracies established the superstructure upon which much of institutional theory currently hangs, argued that irrational, charismatic individuals may be

among the only means of creating institutional change (Weber, 1989, 1994). Indeed, if institutional conformity and the pursuit of legitimacy are rational, then it may well take irrational actors to shape old and create new institutions. More recently, scholars have suggested that certain institutional conditions would have to exist that freed institutional actors to manipulate institutions. This second approach has gained traction within the literature as scholars have outlined what conditions tend to foster institutional entrepreneurship. This approach suggests that the characteristics of an institutional field and actors' social positions can enable institutional entrepreneurship to take place (e.g., Battilana & D'Aunno, 2009; Strang & Sine, 2002).

An institutional field is characterized by the homogeneity of the institutions within it. Fields are "key suppliers, resource and product consumers, regulatory agencies, and other organizations that produce similar services or products" (DiMaggio & Powell, 1983, p. 148). Fields that are institutionally homogeneous are characterized by few institutions, with few intra-institutional overlaps and contradictions. Institutionally heterogeneous fields are characterized by the existence of many institutions, some of which may claim overlapping jurisdiction and proscribe conflicting norms, rules, and values (Ostrom, 2005). Heterogeneity within an institutional field creates conflict between institutions, and this conflict reduces their taken-for-granted nature. In homogeneous fields, institutional entrepreneurs bear a great deal of risk as those institutions are stronger due to their widespread social acceptance. In heterogeneous fields, institutional entrepreneurs may find less risk in changing institutions (Clemons & Cook, 1999; Emirbayer & Mische, 1998; Sewell, 1992).

Fields are also characterized by limited resources, and actors fight to acquire access to these resources while limiting others' access (Bourdieu, 1977, 1990). Some actors find themselves, over time, to have claimed central positions within these fields and abundant access

to resources, while other actors are at the periphery with little access (Shils, 1975). Therefore, an actor's social position can influence whether they engage in institutional entrepreneurship as well as their motivations for doing so (Battilana et al., 2009). Actors on the periphery may be motivated to obtain greater access to resources for themselves and less hesitant to engage in institutional entrepreneurship due to the perception that they have little to lose. For example Maguire and his colleagues (2004) describe how HIV-infected Canadians were able to create a social movement to obtain greater recognition and resources despite their initial, marginalized starting point. Other peripheral actors may attempt to carve out spaces within these fields, by claiming areas that are of little interest to central actors or by working with powerful actors in a way that minimizes their threat (e.g., Santos & Eisenhardt, 2009). Actors in the center of institutional fields may find themselves either more powerful than the institutions that initially constrained them or actually assuming institutional roles themselves. These actors may attempt to alter institutions in such a way to obtain even greater advantages for themselves (e.g., Greenwood & Suddaby, 2006).

Table 5 lists the research conducted on institutional entrepreneurship since 2000 in academic journals, including *Academy of Management Review*, *Organization Science*, *Journal of Business Venturing*, *Entrepreneurship Theory and Practice*, *Journal of Management*, and *Organization*. In reading this research, at least two trends emerge: 1) research tends to focus on the creation of wholly new institutions, and in many of these instances, the new institutions in question are actually organizations or social practices, and 2) although institutional entrepreneurship scholars occasionally draw on concepts found within entrepreneurship theory, such as opportunity, innovation, and risk, no paper has thoroughly integrated topics central to entrepreneurship scholars within institutional entrepreneurship research. In the next section, I

attempt such an integration, which will establish a foundation for the research model presented in Chapter 3.

Please see Table 5

Institutional entrepreneurship, redefined, constrained, and conceptualized. DiMaggio (1988) defined the institutional entrepreneur as an actor who may attempt to alter institutions to obtain a favorable outcome. The institutional entrepreneurship described in this dissertation places some constraints on that definition; specifically, I define institutional entrepreneurship as any deliberate effort by an individual or organization to alter institutional constraints in such a way as to obtain access to new business opportunities or enhance the value of opportunities they are already exploiting. For entrepreneurs, a “favorable outcome” is related to the discovery and pursuit of business opportunities (e.g., Shane & Venkataraman, 2000).

Please see Figure 1

As shown in Figure 1, a given realm of entrepreneurial activity, in which many opportunities exist, is bisected by a formal institutional boundary, or a constraint beyond which behavior is not permitted (e.g., Webb et al., 2009). The entrepreneur or the firm exists on the left side of the figure and is embedded within both formal and informal institutional fields. Opportunities within the formal constraint are legally and socially sanctioned while opportunities without the constraint are illegal but socially sanctioned.² The organization may be embedded in

² No opportunities lie outside of the informal institutional boundary as all opportunities must be based on some degree of social acceptance. However, the informal institutional boundary may be deliberately moved inward or outward by what others have called “moral entrepreneurs” (e.g., Becker, 1963, 1984). For example, the temperance

one or two or dozens of such fields, and the aggregate effect of such fields would be to limit the attainment and exploitation of a wider number of business opportunities. However, for the sake of simplicity, Figure 1 presents a single formal institutional constraint and the institutional entrepreneur's options for changing that boundary. Institutional entrepreneurs may expand constraints to obtain access to new business opportunities. Institutional entrepreneurs may retract constraints to limit access to opportunities by others and thereby enhance the value of the business opportunities they are already exploiting. Finally, institutional entrepreneurs may clarify ambiguous institutional constraints. Institutions are frequently ambiguous, which creates fuzzy institutional boundaries. Ambiguity reduction facilitates either constraint expansion or constraint retraction because the end result is a clearer idea of which side of a constraint an opportunity lies. Constraint expansion or retraction need not involve rewriting policy or law. As described earlier, enforcement is a requisite component of any regulatory constraint; therefore, merely seeking an exemption from a constraint or asking for a constraint to be more strictly enforced constitute institutional entrepreneurship efforts. Finally, while written policy or regulations may be constant across a wide group of firms, in actuality, constraints change on a firm-by-firm basis. Regulatory constraints are often enforced by agents with a wide range of discretion and the predicate rules and regulations are often written with wide latitude (Endicott, 2001). Therefore, regulations are rarely enforced consistently from firm to firm, resulting in unique, if only incrementally different, regulatory environments for each firm.

Given my definition and conceptualization of institutional entrepreneurship as the

movement of the 19th century found some success in framing alcohol as an immoral substance, reducing the social acceptability and, thus, the value of that opportunity (e.g., Hiatt et al., 2009). However, these actors are not institutional entrepreneurs in the sense I use the term because they are not necessarily pursuing business opportunities but are instead driven to label some behaviors deviant in the broader pursuit of “normalcy” (Goffman, 1963). Therefore, this type of institutional change lies outside the scope of this research.

deliberate effort toward institutional change to obtain access or increase the value of business opportunities, not all behavior directed at altering formal institutions would classify as institutional entrepreneurship. Local, state, and federal lawmaker-initiated policy outcomes do not necessarily have any relationship to those lawmakers' pursuit of business opportunities. Lobbying firms also may not always count as institutional entrepreneurs insofar as their business opportunities are related to the *process* of institutional boundary change rather than the outcomes of such changes. Some ideologically motivated individuals and organizations, such as advocacy groups (e.g., the Sierra Club) and think tanks (e.g., the Heritage Foundation) may also not qualify as institutional entrepreneurs, given that they may pursue an institutional change, regardless of an existence of a potential business opportunity.³ Also not institutional entrepreneurs are individuals who benefit from others' institutional entrepreneurship efforts or those who may inadvertently alter institutions but do not intentionally set out to do so.

Institutional entrepreneurship is also a type of entrepreneurship, insofar as it is a process of identifying opportunities to create market value (e.g., Shane, 2003, 2012). The market value institutional entrepreneurs create is related to the access they obtain to business opportunities by shifting and clarifying formal institutional boundaries. The process involves discovering and exploiting opportunities, which institutional entrepreneurs do by developing innovations and assuming risk. Institutional opportunities represent the potential that formal institutional boundaries can be changed or clarified. Innovation constitutes the content of the new or changed institution, which is reflected in a moved or clarified boundary. And risk embodies the unexpected downside costs associated with trying to move a boundary.

Institutional opportunities may be defined as situations in which individuals or

³ However, some notable exceptions exist, such as Charles and David Koch, whose political ideology is directly related to the pursuit of business opportunities.

organizations can introduce new means-ends frameworks to resolve a systematic disequilibrium and create value for themselves and others (cf. Eckhardt & Shane, 2003). Disequilibrium exists when the benefits provided by institutions are outweighed by the costs of conformity, such as when institutions begin to fail, cause confusion, or otherwise become outmoded; therefore, institutional opportunities – or moments ripe for deliberate institutional change – exist whenever the costs of conformity exceed the costs of attempting to change the institution plus the costs of conforming to the new institutional order. There are three types of conformity cost: 1) financial costs (e.g., creating and staffing divisions within an organization to comply with regulatory standards; elsewhere, these can constitute opportunity costs – financial resources spent on conformity that could have been better spent elsewhere); 2) legitimacy costs (e.g., institutional fields may enforce unequal power and resource distributions, which leaves some actors at a constant disadvantage [e.g., Bourdieu, 1977, 1990]); and 3) behavioral costs (e.g., organizations that develop routines based on institutional expectations may be less able to learn and adapt in rapidly changing environments [Adler & Borys, 1996; Hannan & Freeman, 1984; Kelly & Amburgey, 1991]). There are two sets of costs on the other side of the equation. The first set is composed of the costs listed above and constitute the costs of conforming to the new institutional order. The second set of costs is related to an act of institutional entrepreneurship and is composed of two types of cost: 1) the resource commitment necessary to obtain the desired institutional change and 2) the resource commitment necessary to develop the ability to change institutions (e.g., firms may not instantly lobby or make donations to congress members; in some instances, they must first hire lobbyists or create and staff political action committees before engaging in the direct work of obtaining favorable institutional outcomes).

An institutional innovation consists of two dimensions: 1) instrumental (e.g., the

functional institutional content of the innovation) and 2) symbolic (e.g., the framing tactics used by the institutional entrepreneur to obtain social acceptance for the innovation) (Friedland & Alford, 1991). In other words, the instrumental constitutes the “what” and the symbolic constitutes the “how.”⁴ The instrumental dimension is akin to problem solving: the entrepreneur must devise a way to alleviate the friction between their activities and an institutional constraint. Therefore, institutional entrepreneurs select specific solutions to specific problems and are not merely motivated by ideology (Colomy & Rhoades, 1994). The symbolic dimension helps the entrepreneur spread the message – simultaneously advocating for an innovation while arguing against the existing institutional order (Colomy, 1995). In attracting support for an institutional innovation, entrepreneurs draw stark contrasts between their proposed solution and the status quo because delegitimizing the targeted institution is a critical element of institutional entrepreneurship. Status quo institutions are not merely labeled ineffective or inefficient; they are cast as “evil” or “fundamentally unjust” (Colomy, 1995: 272; Turner & Killian, 1987). In place of these corrupt and failing institutions, entrepreneurs portray their projects as just and equitable solutions, and they tout the widespread social agreement that there is a flaw in the system (Eisenstadt, 1995; Turner & Colomy, 1998).

Institutional risks are the unpredictable variances in the outcome of institutional entrepreneurship projects, especially to the downside, and they negatively moderate the likelihood that an institutional entrepreneur will exploit an opportunity to change the institutional order. There are three types of institutional risks: 1) legitimacy (e.g., the entrepreneur may lose any legitimacy derived from the existing institutional order), 2) costs of failure (e.g., institutional innovations, especially formal or regulatory innovations, are frequently voted on or approved by

⁴ The institutional opportunity would represent “why.”

lawmakers, and such either/or outcomes eliminate the chance of even a partial success), and 3) costly success (e.g., an entrepreneur successfully caused the rejection of an existing institution but finds greater difficulty attracting support for the preferred innovation, leaving room for other entrepreneurs to promote their own innovations).

Lastly, research (Lawrence & Suddaby, 2010; Pacheco et al., 2010) has described a number of specific activities institutional entrepreneurs may use to change institutions. For clarity, these activities are listed in Table 6. These activities do not necessarily constitute organizational routines, which will be described in the next section of this chapter, nor do they outline the reasons organizations may use such tactics, which was described in this section. However, they provide a starting point from which the conceptualization and integration of institutional capabilities may begin.

Please see Table 6

Regulatory institutions. The last necessary discussion regarding institutions concerns the unique nature of regulatory institutions, with which this dissertation is particularly concerned. Past this point, the discussion of institutions will be limited to regulatory institutions, or constraints. Regulatory institutions are a subset of formal institutions. Regulatory institutions are those constraints created and actively enforced by regulatory agencies and are frequently, but not always, targeted toward monitoring and policing specific industries (e.g., Bonardi & Keim, 2005; Holburn & Vanden Bergh, 2008). Regulatory constraints have several unique characteristics that distinguish them from other formal institutions. First, unlike contracts, in which one organization constrains the behavior of another organization in the course of discrete transactions, regulatory institutions constrain simultaneously the behavior of all actors across all transactions, usually in a

particular industry. Second, regulatory constraints are frequently created and enforced by governmental agencies, compared to other formal institutions, such as contracts or property rights, which are usually enforced by the contracting parties through the use of civil court procedures, or legal codes, which are enforced by the broader police powers of the city, state, and nation. Third, the relationship between regulatory agencies and the organizations subject to their constraint is frequently closer than the relationships between other agencies and political bodies for two reasons: 1) because regulatory agencies create rules regarding occasionally complex and sophisticated processes, they frequently hire individuals with experience in the industries they regulate, and 2) agencies will frequently interact with organizations during inspection processes.

Regulatory agencies are themselves subject to the same types of institutional forces that constrain all organizations and individuals. As evidenced above, regulatory agencies solicit and incorporate feedback from the firms they regulate, which may serve to reinforce informal industry rules and norms. Since agencies often regulate highly complex and sophisticated industries, they may hire knowledgeable industry members to become regulators. In addition, regulators may rely on industry feedback as a means of becoming aware of new regulatory priorities and writing new rules. Some scholars have suggested that this feedback process from industries to agencies serve as an efficiency mechanism: instead of relying on lawmakers or other governmental actors to propose new rules, for which they may have little knowledge, opening the rule-creation process to industry actors helps cut costs and may make the regulatory process more efficient (Holburn & Vanden Bergh, 2004; Spiller, 1990).

In addition to the influence on regulatory agencies by industries, regulatory agencies are also influenced by legislative entities and executive oversight. Legislatures pass laws that compel

regulatory agencies to write new rules, and agencies are often overseen by a politically appointed commission or board that ensures that agencies behave according to lawmakers' expectations. Scholars often presented this relationship through the lens of agency theory and the principle-agent interaction, in which lawmaking bodies are the principle and regulatory agencies are the agents (e.g., Shapiro, 2005). Through this lens, regulatory agencies may pursue interests different than those of the lawmaking bodies, agents may extract perquisites from the agencies, and they may behave opportunistically (e.g., accepting bribes, shirking responsibilities, etc.) (Shapiro, 2005). Monitoring costs for principles can be very high. As stated above, agencies regulate highly complex industries, and many of the actors within agencies may be former industry members and have detailed, content-specific knowledge. This information asymmetry may make it difficult for principles to thoroughly monitor regulatory agencies. Also increasing monitoring costs is the tenure differences between the principle and agent: lawmakers are often transient, leaving office at the end of a political term, while regulatory actors may be less transient and remain in their jobs through several political administrations. As a consequence of principles' high monitoring costs and agencies' close relationship with the industries they regulate, regulatory agencies are at risk of "institutional capture," a situation in which the influence industry wields over an agency is more powerful than the influence wielded by lawmakers (Bo, 2006; Laffont & Tirole, 1991). For example, the Deepwater Horizon oil spill in 2009 has been partly blamed on lax regulatory supervision of British Petroleum's deep-sea drilling operations. Legal scholars have suggested that this lax supervision was an outcome of the close relationship between BP and the U.S. secretary of energy, Steven Chu, a researcher who previously had received almost \$500 million in grant money from BP to create a "Energy Biosciences Institute" (Grant, 2010).

One last unique characteristic of regulatory agencies and the constraints they create and enforce is the deliberative process through which institutions are created. Rules are often proposed and influenced with heavy involvement of industry. For example, rules proposed by the Federal Accounting Standards Board are posted online and open to comment for a period of at least six months before being adopted as a generally accepted accounting procedure. The comment period, during which anyone or any organization may offer opinions, potentially influences the nature of the proposed rule or even whether the rule is adopted. Other regulatory agencies follow similar processes. The period of time between a rule's proposal and adoption has been referred to as a "zone of discretion," which organizations may use to wield influence and obtain favorable outcomes (Ackerman, 1973; Silverstein & Hohler, 2010). Other opportunities exist for organizations to influence regulatory institutions and will be described in the section describing institutional capabilities.

ORGANIZATIONAL CAPABILITIES

Capability overview

A capability is a "high-level routine (or collection of routines) that, together with its implementing input flows, confers upon an organization's management a set of decision options for producing significant outputs of a particular type" (Winter, 2003: 991). Organizations are filled with routines, which Nelson and Winter (1983) liken to genetic codes of the firm. Organizations rely on routines to guide everything from the processing of payroll checks, to the ordering of new inventory, to hiring and evaluating employees, even to establishing how janitors best clean an office or a bathroom. Organizations are resource-limited, and they rely on routines to free up resources that may be dedicated elsewhere to assist in encountering environmental change and solving problems. Therefore, organizations will develop and maintain routines for

everything from the most mundane tasks to those most central for value creation. The routines most central to value creation are called capabilities (Winter, 2003). Not all routines constitute capabilities: for example, the accounts receivable clerk processing invoices is enacting a routine, but this routine is unlikely to deliver sustained competitive advantage to the firm. However, some routines may become truly unique to an organization as a central component of its competitive strategy. In extreme cases, an organizational capability may become so valuable it can serve as the foundation for a new, stand-alone organization (e.g., American Airline's electronic customer service platform, called SABRE, eventually became the independent company Travelocity).

Scholars have described several types of capabilities. Market capabilities are those that enable organizations to anticipate customer wants and competitor actions, managing customer relationships (Day, 1994). Organizations with market capabilities may be better able to detect external or environmental changes and feedback. Others have described capabilities related to linking engineering functions and legal functions in the firm (i.e., leading to better contracting) (e.g., Argyres & Mayer, 2007); capabilities related to establishing lean manufacturing production and managing cost efficiencies (e.g., Corbett & Campbell-Hunt, 2002); and fostering and utilizing experimental problem solving within organizational divisions, which are then spread throughout the firm as common practices (Salvato, 2009). Dynamic capabilities are higher-order capabilities used by firms to quickly react to changing environmental conditions and improve the firm's underlying value-creating capabilities (Drnevich & Kriauciunas, 2011; Eisenhardt, & Martin, 2000; Winter, 2003).

Institutional capabilities are those capabilities developed and leveraged by the firm to perceive their institutional environment, interact with, and manipulate the formal institutions in

which they are embedded. As with other capabilities, institutional capabilities enable a firm to obtain competitive advantage; firms are able to wield these capabilities to manipulate boundaries and obtain access to business opportunities not available to other firms. While a number of firm capabilities may constitute a broad institutional capability, these capabilities may be separated into three sub-categories: 1) capabilities that enable a firm to perceive its regulatory environment, 2) capabilities that enable a firm to interact with its regulatory environment, and 3) capabilities that enable firms to manipulate its institutional environment. These capabilities will be described in much greater detail next.

Perception capabilities

Perception capabilities are those through which firms detect and comprehend institutions. Firms will not necessarily be aware of the constraints in which they are embedded. Larger firms or ventures that experience rapid growth may extend into new formal institutional jurisdictions and encounter wholly new sets of formal institutions. While older firms may have become familiar with their original formal institutional environment, they may be less likely to be fully aware of the characteristics of the new environment. New firms or young entrepreneurial ventures may also be unfamiliar with the constraints placed upon the industries they enter. Firms that encounter unexpected constraints may be subject to costs, such as fines and other penalties, and in other cases, strict constraints may make firm activities completely unfeasible. Therefore, firms may obtain advantage over their competitors by developing capabilities related to perceiving formal institutions. Perception capabilities may be composed of a number of routine activities, such as constantly scanning their regulatory environments (i.e., content detection), seeking out and detecting other actors with regulatory interests (i.e., field awareness), and comprehending the substantive meaning and requirements of regulatory constraints (i.e.,

ambiguity reduction).

Content detection. That actors perceive and understand regulatory constraints is a common assumption made by institutional theorists (e.g., Oliver, 1991). Oliver writes that firms' ability to determine appropriate strategic responses to institutional pressure is, at least in part, dependent on firms' awareness that an institution even exists or that such existence has implications for firms. Institutional awareness itself remains little studied, although it may be the lynchpin with which the rest of institutional theory hangs together. Firms cannot conform to, interact with, or manipulate institutions that they do not perceive.

Executives, managers, and entrepreneurs' ability to perceive their institutional surroundings may be related to their ability to share similar structures of thought with actors embedded within formal institutions, or what Hinthorne (1996: 259) calls the ability to "sense and utilize a potential congruency of perceptions between [firms] and other stakeholders." By other stakeholders, he means regulators, judges, and other formal institutional actors. Hinthorne (1996) argues that actors within firms rely on "intuitive processes" or a general awareness of the law to infer where institutional boundaries may lie and where there is room for action. These intuitive processes, which are related to understanding formal institutions, may be combined with regular scanning behaviors targeted toward a firms' institutional environment (e.g., Elenkov, 1997; Hambrick, 1982) to accurately detect the existence and content of formal institutions.

Examples of these sorts of capabilities would include firms that regularly incorporate their legal counsel's office while determining broader strategic directions for the firm. A firm's attorneys have, through access to human capital (i.e., their education and experience), acquired the structures of thought and intuitive processes described by Hinthorne (1996), and they also likely stay up-to-date in legal issues pertaining to their firm and serve as their organization's

scanning mechanism (e.g., Nelson & Nielson, 2000). Other examples may also include firms that more readily use courts to settle business competition issues. For example, Hinthorne (1996) describes how Continental Airlines would regularly turn to legal means for settling competitive disputes or supply chain disputes before using other means. Such repeated use of formal institutions may, in and of itself, contribute to firms' perception of formal institutions it was previously unaware of.

Field awareness. Fields contain the “key suppliers, resource and product customers, regulatory agencies, and other organizations that produce similar services or products” (DiMaggio & Powell, 1983). Fields are also characterized by social hierarchies, in which some firms may possess high status and others low status. Fields are also highly political arenas, rife with content, in which some actors may fight for institutional change and others defend it (Battilana, 2006; Bourdieu & Wacquant, 1992; Brint & Karabel, 1991). Firms are able to use field awareness capabilities to detect and understand the relationships, overlaps, and conflicts among the multiple institutions within the field (e.g., Battilana et al., 2009). Conflicting institutions tend to de-legitimize each other, creating opportunities for actors to affect institutional change. As field heterogeneity increases, characterized by greater degrees of overlapping institutions and conflicting institutions, individual or organizational actors are more likely to be successful in efforts to alter institutions in their favor (e.g., Bonardi, Hillman, & Keim, 2005; Emirbayer & Mische, 1998).

Ambiguity reduction. Regulations are frequently opaque and complex (Edelman & Suchman, 1997). While firms may accurately perceive the existence of a regulatory constraint, the substantive meaning of these constraints is not always immediately clear (Endicott, 2001; Sorenson, 2001). First, the words or phrases that constitute a particular regulation acquire, over

time, meanings that are different from when they were originally written. One of the more obvious examples would be the meaning of the word “people” in the United States Constitution, which is much more inclusive today than it was when written in 1787. In addition to changing meaning, formal institutions contain stipulations that are substantively ambiguous – that is, a regulation may be deliberately ambiguous in order to allow for a wider discretion of an enforcing agent. For example, Endicott (2001) describes driving laws as being necessarily vague because lawmakers are unable to write precise enough laws to cover the infinite range of how people may drive dangerously; therefore, law is written so that a police officer has latitude in determining what behavior is dangerous. Third, regulations are themselves constantly being proposed, repealed, and revised. Regulatory agencies do not necessarily publicize every change, although they may have great effect on how firms conduct business. Fourth, and lastly, institutional overlap or conflict can create ambiguity. For example, Colorado and Washington passed laws in 2012 that legalize the possession of marijuana, while such possession is still illegal under the federal Controlled Substances Act (Tarm, 2013). For entrepreneurs contemplating exploiting opportunities related to drug legalization, the institutional environment is certainly ambiguous and entails risk.

To reduce this ambiguity, firms may use routines that leverage their human and social capitals. Like the other two types of perception capabilities, this capability is based on the routinized acquisition of information regarding formal institutions. Therefore, firms that have the requisite human capital to know what laws say and how to resolve vague meaning and firms that have acquired the social capital, such as establishing relationships among actors within formal institutions, may lend these firms a competitive advantage. A recent example in Oklahoma involves a winery, which, upon reading the regulation that wine may be served by the glass at

“festivals and trade shows,” contacted the state alcohol regulatory agency. The term evidently contained some ambiguity: in 2011, the winery asked if malls fell under the definition, and the commission agreed that they did. However, the next year the commission reversed its decision, stating that they hoped the state legislature would more clearly define the term (Palmer, 2012).

Interaction capabilities

Interaction capabilities are those routines that firms develop to obtain, maintain, and benefit from relationships with the regulatory agencies that create institutions. While the perception of institutions is a critical component of managing the institutional environment, interaction capabilities unlock additional value for the firm. Formal institutions emerge as a result of the political processes that occur between lawmakers, regulators, and private or constituent interests, and regulated entities (Wilson, 1980). Therefore, firms that are able gain access to and influence these processes may be able to obtain an advantage over firms that do not (e.g., Claessens, Feijen, & Laeven, 2008; Ferguson & Voth, 2008). Firms may develop three types of capabilities that enable them to successfully interact with their institutional environment: capabilities related to obtaining institutional access (i.e., securing a legitimate and useful “seat at the table” with which to wield influence); capabilities related to mitigating risk (i.e., reducing institutional uncertainty through actions aimed at maintaining the institutional status quo), and capabilities related to domain maintenance (i.e., fending off institutional challenges to control *how* firms produce value).

Obtaining access. Firms that pursue competitive advantage through institutional means *without* access to the political processes involved may face a daunting path. In some instances, firms may simply elect not to engage in activities that would bestow access. For example, firms may be too small to sacrifice capital for campaign donations, firms may operate in lightly

regulated environments, or some regulatory agencies are so inimical to business interests that they may deny access to firms (e.g., Hillman, Withers, & Collins, 2009; Kelman, 1980). For example, Kelman (1980) describes how the U.S. Occupational Safety and Health Administration (OSHA), which regulates workplace and employee safety, is staffed by individuals who come from public health backgrounds and who often have philosophies or shared values that may be opposite of those entities regulated by OSHA.

However, where firms are able and willing to obtain access to regulatory agencies, access itself may be an important source of competitive advantage. One of the primary activities firms use to obtain access and that is described in the literature involves placing former political and regulatory actors on firm boards or by having firm executives placed within high governmental positions (Hillman et al., 2009; Hillman, Zardkoohi, & Bierman, 1999; Goldman, Rocholl, & So, 2009). As popular examples of this activity, Goldman and colleagues offer Vice President Dick Cheney, who served on the board of Halliburton in between stints as secretary of defense and vice president, and Vernon Jordan, a Clinton confidant who has served on at least 10 boards. These connections enable firms to navigate the complex political regulatory environment. At least in the Halliburton example, their political connection paid off: the company was awarded contracts to rebuild the Iraq oil infrastructure after the second gulf war, and its subsidiary, KBR, was awarded more government contracts in Iraq than any other private firm (Goldman, et al., 2009; Miller, 2007). This activity has proven successful in helping firms manage their institutional environment as more than half of all publically traded firms have appointed individuals with political experience on their boards (Goldman et al., 2009).

Firms may also simply purchase access (Hart, 2001; Langbein, 1986). That money buys influence is not necessarily a given – money does not carry messages regarding a firm’s policy

preference. However, money may be useful in buying face time. Empirical evidence suggests this is so: Langbein (1986) was able to show that contributors spent significantly more time with lawmakers than non-contributors, leading to the conclusion that money at least unlocks doors. Firm giving patterns are congruent with the finding that money buys access and not policy outcomes. According to FEC records, the three companies among the top 11 most politically giving firms – Honewell, AT&T, and Northrup Grumman – almost evenly split their donations among Republicans and Democrats, giving to both parties fairly equitably (OpenSecrets.org, 2013). If firms were pushing policy agendas with their cash reserves, giving patterns would likely be less even.

Capitals that are deployed by access obtainment strategies would be the firm's social capital, produced capital, and cultural capital. Human capital may play a role, as individuals acquire relationships through their prior experience working within formal institutions, but its role is indirect and likely fully accounted for by social capital. Social capital provides firms with access to knowledge held by formal institutions as well as the ability to influence such institutions through the exchange of information (Nahapiet & Ghoshal, 1998). Produced capital, such as the cash firms acquire, political action committees they launch, the government contracts they possess, and the lobbyists they hire, are critical resources deployed by access obtainment capabilities. Finally, cultural capital, or the accrued legitimacy of a firm, may also be leveraged by access obtainment strategies. Firms that have a great deal of legitimacy, such as that achieved through means such as their selective appointment of directors, signal to formal institutions their willingness to play (Bourdieu, 1986; Nahapiet & Ghoshal, 1998).

Risk mitigation. Firms bear risk when they are aware of the possible outcomes of an action or event but remain unaware of the probabilities associated with each outcome. One of the

roles of institutions is to reduce part of this risk by establishing rules that are constant through time and applied equally to all organizations. Economic actors can largely count on institutions to exist some distance into the future, which reduces their uncertainty, and risk, regarding future outcomes (North, 1990). However, in some instances, institutions may fail to reduce risk. Institutions may fail to reproduce themselves for a number of reasons, such as changing social conditions or shifting political demands (Oliver, 1992). Formal institutions may also fail to reduce risk in one other aspect, such as when they change laws, add regulation, deliberately create ambiguity, and practice capricious or arbitrary enforcement. When institutions arbitrarily exercise power (e.g., North & Weingast, 1989), they increase the risk firms face by reducing their ability to predict future outcomes.

Firms that develop risk mitigation strategies are not able to reduce the amount of social and political change inherent in the vibrant realm of human activity, but they might be able to reduce institutional change to perpetuate certain conditions into the future and reduce risk (cf. Oliver & Holzinger, 2008). When institutional changes are perceived by firms as threats, these firms may use risk mitigation capabilities to support the status quo. For example, Oklahoma-based Hobby Lobby is currently suing the federal government to prevent the implementation of parts of the Affordable Care Act (e.g., the requirement that employee-provided health insurance cover birth control), which may increase costs for the company and which the company argues goes against its core values as a Christian-oriented firm (Bailey, 2013).

Oliver and Holzinger (2008) argue that risk mitigation capabilities depend heavily on the social capital of the firm: firms that are able to acquire and foster trust among regulatory actors are more likely to be able to successfully influence institutional outcomes. Trust reduces the costs of ascertaining the veracity of new information for both sides in a relationship but, in this

situation, most importantly for actors embedded within institutions (Dyer & Singh, 1998; Hillman & Hitt, 1999; Gulati & Gargiulo, 1999). With lower information costs, firm advocacy is more likely to influence institutional outcomes. Therefore, advocacy is a primary activity that constitutes risk mitigation strategies and could include lobbying against regulatory changes and asking lawmakers to support industry- or firm-friendly rules. Legal action may also constitute a type of risk mitigation activity – such as that used by Hobby Lobby to stymie the implementation of new law. Here, human capital is an important resource that may be brought to bear. Just as in the description of perception capabilities, human capital may be just as important in enabling firms to detect institutional changes and resisting them.

Domain maintenance. Risk mitigation capabilities are one type of defensively oriented capability – they protect the firm against the risks created by changing institutions. Domain maintenance capabilities are another type of defensively oriented capability – they protect firms from intrusive actions by regulatory agencies that may increase the costs related to value creation (Baysinger, 1984; Crane, 2013). Changing institutions create uncertainty, which increases risk for the firm. Some institutional changes are certain, clear, and lasting, and they may have detrimental effects on firms’ performance. For example, in a recent talk⁵ given at OSU, Richard Scrushy, the founder of HealthSouth, described the deleterious impact on the healthcare industry created by a shift in how Medicare reimbursed hospitals.⁶ He said the shift had obvious implications for the future: the lowest-cost healthcare providers would prevail, and he founded HealthSouth to capture the opportunity. Hospitals, therefore, did not necessarily face risk in the

⁵ Delivered in Stillwater on March 28, 2013.

⁶ Before the 1980s, Medicare reimbursed healthcare providers’ costs. Perhaps not surprisingly, under that regime, healthcare costs had doubled approximately every five years. To cut costs, Medicare shifted to reimbursing hospitals using a capitated system: patients were assigned to federally recognized diagnosis-related groups, and Medicare reimbursed a flat rate per patient (Fetter & Freeman, 1986). This incentivized hospitals to cut costs, where the prior incentive had been to inflate costs.

policy change – as the implications were obvious. Instead, the policy change bore directly on hospitals’ ability to produce and capture value.

The activities that constitute domain maintenance capabilities are also those that constitute risk mitigation capabilities and include wielding influence with lawmakers and filing suit against laws that threaten firm activities. The resources brought to bear are also similar to resources used in risk mitigation capabilities and are mostly comprised of social capital (Oliver & Holzinger, 2008). Nevertheless, it may be worth distinguishing the two sets of capabilities because the reasons these capabilities are deployed is different, and capabilities serve as the mediator between resources and strategy; therefore, different strategies require different capabilities (e.g., Sirmon et al., 2003).

Manipulation capabilities

Manipulation capabilities are those capabilities that firms develop to shift institutional boundaries in order to 1) expand boundaries to obtain access to new business opportunities, 2) retract boundaries to restrict access of currently exploited opportunities from others and 3) create boundary ambiguity, which may have a similar effect as boundary retraction and prevent less-capable firms from exploiting opportunities targeted by other firms. Where politically agnostic firms may develop perception and interaction capabilities to enable them to deal with occasional institutional threats, firms that develop manipulation capabilities may be more likely to have strong and lasting policy preferences, perhaps akin to ideologies (Colomy, 1995; Colomy & Rhoades, 1994). Rather than dealing with the occasional institutional threat, firms with manipulation capabilities develop policy preferences and seek opportunities to introduce them (cf. DiMaggio, 1988). Firms may develop three types of manipulation capabilities: capabilities related to expanding institutional boundaries (i.e., proactive manipulation capabilities),

capabilities related to retracting institutional boundaries (i.e., defensive manipulation capabilities), and capabilities related to smudging or obfuscating institutional boundaries (i.e., ambiguity creation capabilities).

Proactive manipulation capabilities. Proactive manipulation capabilities push institutional boundaries out, making legal that which was previously illegal. These firms believe that lucrative business opportunities exist outside the realm of activity proscribed by formal institutions, and they bring to bear resources to attain these opportunities. For example, Greenwood and Suddaby's (2006) study describes how accounting firms, which had begun to experience slower growth, decided to branch out and provide consulting services to firms it had only previously provided accounting and audit services. Another, more recent example, involves the banking industry, where the Glass-Steagall Act of 1933 had prohibited commercial banks from conducting investing activities. This provision of the act was repealed in 1998, allowing commercial banks to acquire investment banks and conduct investing activities, which some argue as a triggering event of the banking industry collapse a decade later (e.g., Stiglitz, 2009).

The activities that firms use to expand regulatory boundaries primarily include framing and social movement organizing (Benford & Snow, 2000; Misangyi, Weaver, & Elms, 2008; Rao, Morrill, & Zald, 2000). Framing activities help firms develop their policy positions and disseminate these positions to other social actors, and social movement activities attract support to make the appropriate institutional change. The concept of framing has already been introduced in the preceding chapter as the "action-oriented sets of beliefs and meanings that inspire and legitimate the activities and campaign of a social movement organization" (Benford & Snow, 2000: 614). Framing consists of three, interrelated activities: diagnostic framing, prognostic framing, and motivational framing (Markowitz, 2007; Misangyi et al., 2008). Diagnostic framing

is used by the firm to point out how current institutions are failing and must be revised.

Diagnostic framing may lead to firms using strong, harsh language to motivate social support and delegitimize the existing institutional order (Colomy, 1995). For example, Tom Monaghan, the founder of Domino's Pizza, filed a lawsuit to halt the implementation of portions of the Affordable Healthcare Act, ostensibly using legal constitutional arguments. He nevertheless has called the act "gravely immoral" and refers to it as such in his suit (Associated Press, 2012).

Firms use prognostic framing to present their solution to the institutional problem as well as to justify their role as institutional entrepreneurs, which may give them social approval as change agents (Creed, Scully, & Austin, 2002). Motivational framing stimulates others to action.

Framing activities and the social movement organization that it precipitates rely on all firm resources, but perhaps most importantly social capital, produced capital, and cultural capital. Social capital, which includes relationships with other firms within the industry, may help the firm to rapidly accumulate social support for its actions, should firm interest be congruent with industry interests. Produced capital provides the infrastructure for quickly disseminating the firm's message, whether that involves deploying PACs and lobbyists to contact politicians or for stimulating public awareness and support through issue-oriented advertising and grassroots efforts. Cultural capital, especially that generated by the firm's legitimacy among lawmakers and its customers, lends credibility to the firm's message and may make it more likely to be approved and implemented.

Defensive manipulation capabilities. This type of institutional capability is similar to proactive capabilities, relies on similar activities, and deploys similar resources – but all to a different end, making them a unique type of institutional capability. Defensive manipulation capabilities enable firms to retract institutional boundaries, which has the effect of protecting

opportunities already being exploited by the firm and making them more valuable. Outcomes of defensive manipulation capabilities primarily consist of barriers to entry. Firm may solicit lawmakers to pass licensure requirements for certain activities. Licensure has the effect of rendering some opportunities illegal; for example, though an individual may discover an opportunity related to hair design in a small town, they cannot exploit that opportunity without first obtaining a license. Firms may also seek policy that excludes outright some forms of economic activity; for example, one stipulation of the Affordable Healthcare Act is to prohibit physician-owned hospitals built after 2010 from receiving Medicare reimbursements, effectively rendering this form of organization ineffective (Scandlen, 2013). The law was supported by many in the hospital industry, which perceived physician-owned hospitals as threats (e.g., Lillis, 2012). And firms may simply seek increased levels of regulation for their industry, which has the effect of reducing the number of smaller competitors that do not have adequate resources to comply with increasingly onerous regulation (Danzon & Chao, 2000).

Ambiguity creation capabilities. The final set of capabilities described in my model are those capabilities that *create* institutional ambiguity where none existed before. Institutional ambiguity, as described earlier in this chapter, is frequently the outcome of institutional processes: 1) formal institutions are unable to exactly or even adequately capture every possible combination of human activity, so they create laws and regulations that require the use of discretionary enforcement and 2) the constant churn of formal institutional content, in the form of shifting laws, rules, and regulations, that frequently remain unpublished and even unnoted. Another source of institutional ambiguity may be brought about by the actions of firms. These actions may be intentional or unintentional, but they have the result of obfuscating an institutional boundary that had previously been relatively clear.

Institutional boundaries are aggregate compositions of all the formal institutions regulating or otherwise influencing a field of activity. Boundaries are clearest when these institutions are in alignment and the fuzziest when they are not in alignment. Ambiguity creation capabilities, therefore, include those activities that attempt to misalign formal institutions within a field. This type of capability is frequently displayed by social movement organizations that will often challenge the same laws in different states to create jurisdictional conflict, which congress or the Supreme Court resolve (Lindquist & Klein, 2006). The activities that constitute this capability are strongly legal in nature and draw on the human capital of the firm, such as that held by the firm's office of legal counsel. The outcome of this capability is a sort of external causal ambiguity. Causal ambiguity is a concept within strategic management and is created by firms in order to reduce the imitability of its resources (Reed & DeFillippi, 1990). Theoretically, firms may also attempt to create causally ambiguous environments, including institutional environments, and make it harder for other firms to identify and exploit the same or similar opportunities.

The origins of capabilities, and how capabilities enable value production

Firms are embedded in environments rife with uncertainty and in which decision making can be laborious and costly. As a consequence, firms will develop decision-making patterns, based on past trial-and-error experiences, that facilitate rapid decision making for routine activities, which frees the firm to spend more time and resources on more important problems (Cyert & March, 1963; March & Simon, 1958). These established decision-making patterns form the foundation of organizational routines, which are activities repeated within a firm to achieve certain, basic ends (Nelson & Winter, 1982). Basic firm routines can include a wide range of activities, such as how to process billing, how to hire employees, or how to conduct inventories

of goods to be sold. These organizational-level routines emerge from the experience of individuals within the firm, who, from their own past experience, come to form cognitive patterns regarding how they understand and process information and make decisions (Weick, 1995). Routines, therefore, are frequently influenced by the characteristics of the individuals who make up the firm and are born in the interactions among members and leaders of the founding team (Helfat & Peteraf, 2003). The most basic routines enable firms to conduct day-to-day business, or “repetitive patterns of activities” (Nelson & Winter, 1982: 97). Other routines are central to how the firm produces value, whether through manufacturing products or delivering services to customers (Winter, 2000). These higher-importance routines are used by the firm to acquire, bundle, and leverage resources in the production of manufactured goods or the delivery of service to customers. Moreover, capabilities serve as the link between the resources a firm has at hand and the firm’s ability to pursue a desired strategy: a firm may possess any number of valuable resources, but without the ability to deploy these resources in a way that creates value, they lie dormant. (Newbert, 2007; Sirmon et al., 2007).

Capabilities have been linked to improved firm sustainable competitive advantage, or performance, in a number of ways. The firm that develops capabilities related to producing products and services may find ways of reducing the costs associated with the production process (e.g., Brush & Artz, 1999; Drnevich & Kriauciunas, 2011). Firms that become adept at deploying capabilities in certain markets may also become better at obtaining feedback from those markets and improving their ability to identify and exploit new opportunities (Sirmon & Hitt, 2003; Sirmon et al., 2007). In sum, capabilities enable firms to produce products and services in new and more efficient ways, perceive under-served customer segments and market products and services to them, and energize organizational structure, fostering intra-firm communication and

producing efficiencies in how the firm administers its activities.

Capabilities and institutions

The notion that organizations are invariably and involuntarily subject to institutional constraints has largely faded away in favor of a perspective that recognizes that organizations have at least some (or a great deal) of discretion over their own actions (DiMaggio, 1988; Greenwood & Suddaby, 2006). And as scholars turn away from a perspective that sees the restrictions enforced within the organization-institution relationship, another perspective is emerging that recognizes that organizations may, indeed, be able to use institutions to advance their own interests and exploit opportunities (Bagley, 2008; Crane, 2013).

Firms have apparently recognized this fact for themselves, especially with regard to taking advantage of formal institutions. Today, a growing proportion of firms are hiring lawyers as executives (France & Laville, 2004), and organizations have embraced the legal expertise in their counsel offices as a critical element of business success (Siedel, 2002). In terms of affecting legislative outcomes, scholars have examined the different resources firms acquire or develop for themselves, such as hiring lobbyists, opening company offices near political or legislative centers, constructing political action committees (i.e., organizations that make political donations or conduct policy advocacy under the aegis of a business firm), or obtaining government service contracts (Grier, Munger, & Roberts, 1994; Hart, 2001; Hillman et al., 2004; Schuler, 1996; Schuler, Rehbein, & Cramer, 2002; Shaffer, 1995). These resources buy firms access to the political process, and they may even build the close ties necessary for firms to wield influence in shaping policy. However, in order for these resources to be effective, they must be acquired, bundled, and leveraged with capabilities directed at interacting with the institutional environment (Sirmon et al., 2007).

CHAPTER 3 HYPOTHESES

The research model presented in Figure 2 demonstrates how firms may use institutional capabilities to move regulatory constraints as a means through which to access greater entrepreneurial opportunities and increase the value of opportunities they are already exploiting. In so doing, these firms are able to use institutional capabilities as a primary means of obtaining competitive advantage. Institutional capabilities facilitate constraint expansion and constraint retraction. Costs associated with conforming to regulatory constraints is one of several moderators of this relationship. When costs are high, firms are more likely to deploy institutional capabilities to expand constraints, and when costs are low, firms are more likely to deploy institutional capabilities to retract constraints. Regulatory framing, which may be defined as the lens through which firms view their regulatory environments, positively moderates the use of institutional capabilities to bring about any type of regulatory change. Perceived regulatory complexity negatively moderates the use of institutional capabilities and results in a lower likelihood that firms will use institutional capabilities to bring about any type of regulatory change. Finally, constraint expansion is positively related to greater firm access to opportunities while constraint retraction is positively related to greater firm returns on current activities (i.e., the opportunities they currently exploit will become more valuable).

Please see Figure 2

Institutional capabilities to constraint expansion/retraction

Attempting to change these constraints can be very costly and entail substantial risks (Keim & Baysinger, 1988). Regulatory institutions are frequently the outcomes of political processes that involve many actors and that often produce either-or results: either a bill is passed or it is not, either a regulation is adopted or not. Even when firms successfully obtain access to the process, their ideas are likely to be mixed with those of other political actors, resulting in a compromised outcome, which may not always be favorable to the firm. Finally, regulatory institutions and formal institutions more broadly may leverage their power to punish firms that seek change (e.g., Eilperin, 2013; Kelman, 1980).

While constraint change may involve the creation of new written regulatory policy or new law, this need not always be the case. A critical characteristic of any constraint is its enforcement by regulatory agencies (Ostrom, 1986). Therefore, written policy or law that is not enforced do not constitute constraints. Moreover, written laws or policies may be regulated differently, on a firm-by-firm basis, especially as regulators possess some discretion in how to enforce constraints (Endicott, 2001). For example, consider the regulations facing the nuclear power industry. The U.S. Nuclear Regulatory Commission requires nuclear power plants to have licenses to lawfully operate. However, recently the license at the Indian Point power plant in New York expired, and instead of immediately shutting down the plant, regulators have permitted the plant to operate, citing extenuating circumstances, such as the complication of the licensing procedure and that the plant had applied for license renewal several years before the expiration date. The result today is that the Indian Point power plant is the only nuclear plant in the United States to operate legally without a license, despite written regulatory policy and despite public outcry (Associated Press, 2013). Therefore, when regulatory constraint change is

discussed, it is important to consider 1) that though written regulatory policy may be constant across all firms, in reality, regulatory discretion in enforcement results in firm-to-firm constraint differences and 2) that while regulatory change may involve written changes in law or policy, it may also be as simple as a firm seeking for and being granted a temporary exemption from enforcement.

Institutional capabilities facilitate constraint change in a number of ways. Institutional capabilities enable firms to perceive their regulatory environments and establish causal connections between the costs they bear and particular constraints (e.g., Hinthorne, 1996). They may also enable firms to locate and determine what other actors have interests at stake in a regulatory constraint (Bonardi, Hillman, & Keim, 2005; Emirbayer & Mische, 1998). And institutional capabilities may allow firms to more quickly comprehend complex and ambiguous regulatory constraints and the regulatory environment at large, which may enable them to more rapidly determine how to effect the changes they seek (e.g., Edelman & Suchman, 1997).

Not all institutional capabilities are directed at manipulating regulatory constraints themselves but are instead directed at the regulatory agencies that propagate constraints, such as those described in the preceding chapter as institutional interaction capabilities. These capabilities allow firms to obtain a position in the political area, which they may use to voice their opinions regarding constraints, offer alternatives, and garner the necessary support inside regulatory agencies to push forward a constraint change (Claessens, Feijen, & Laeven, 2008; Ferguson & Voth, 2008). Such capabilities may also allow the firm to avoid alienating regulatory actors, who may be motivated to tighten constraints on firms that seek constraint change, by building long-term relationships within a regulatory agency or by managing to place former industry members in places of power within an agency (e.g., Baysinger, 1984; Crane, 2013).

Moreover, firms may use these capabilities to wield influence at higher levels of formal institutional apparatuses, enabling them to bypass regulatory actors and seek changes through using relationships with more important political actors or legislative bodies (e.g., Schuler, Rehbein, & Cramer, 2002; Shaffer, 1995).

Finally, institutional capabilities enable firms to organize support to achieve their desired regulatory outcomes by communicating their message effectively to outside actors. Firms may become adept at regularly deploying any of the tactics listed in Table 6. In particular, firms may attempt to deploy their regulatory framing, which they develop for themselves to understand and interpret regulatory environments, outside the firm, either to regulatory agencies, legislative bodies, or other stakeholders outside the political process (e.g., Benford & Snow, 2000; Rao, Morrill, & Zald, 2000). These activities may garner broad-based support for a firm's desired change. Similarly, firms may also use theorization tactics, likely aimed at similar firms facing the same constraints: not all firms will have developed institutional capabilities or even be aware that the costs they bear are connected to constraints placed by regulations. Theorization would reduce such ambiguity for other firms and draw causal connections between constraints and costs (Pacheco et al., 2010). This tactic would have the ultimate effect of drawing other firms onto the side supporting regulatory change.

In sum, firms that possess institutional capabilities will be adept at determining what constraints are the most costly and plotting a path for manipulating constraints, once identified. Moreover, institutional capabilities enable firms to garner broader support for a proposed regulatory change, making it more likely that such a change will take place. Institutional capabilities facilitate constraint change, whether in expanding or retracting constraints; thus, we would expect:

Hypothesis 1a: Firms' possession of institutional capabilities will be positively related to constraint expansion.

Hypothesis 1b: Firms' possession of institutional capabilities will be positively related to constraint retraction.

Regulatory costs moderate the relationship between institutional capabilities and constraint expansion/retraction

Institutions emerge as actors, in an effort to reduce uncertainty, establish shared guidelines for behavior that are relatively stable through time and thus reduce part of the variability firms encounter in the environment (DiMaggio & Powell, 1983; Meyer & Rowan, 1977). Firms that behave within the constraints established by regulatory agencies are, therefore, able to obtain certain resources that would not otherwise be available to them, such as official sanction and legitimacy (Scott & Meyer, 1991; Suchman, 1995; Zimmerman & Zeitz, 2002). Constraints are durable through time because the benefits they provide to firms tend to outweigh the costs of conformity (North, 1990; Oliver, 1992). However, some regulatory constraints may levy costs that outweigh the benefits of conformity, and firms may take certain actions to avoid or reduce these costs. For example, the passage of the Sarbanes-Oxley Act in the wake of several major corporate accounting scandals, requires publically traded firms to follow stringent processes regarding the production of financial statements. While many firms comply with the act's requirements, judging that the benefits they receive from the public equity markets outweigh the costs of conformity, other firms determined that the costs outweighed these benefits and withdrew from public equity markets (Kamar, Karaca-Mandic, & Talley, 2009).

When the costs firms bear due to their regulatory constraints becomes burdensome, they are more likely to attempt to change these constraints. Seo and Creed (2003) argue that there are four specific types of institutional costs borne by firms: 1) the costs of creating conformity mechanisms within the firm that are independent from central firm functions (i.e., loose coupling

[Meyer & Rowan, 1977]), 2) increased firm stagnation and reduced ability to adapt to changing circumstances, 3) conflict with other institutions (e.g., conformity to a particular constraint places the firm in conflict with other, contradictory constraints, and 4) reduced ability to pursue strategies important to the firm, such as when firm interests and regulatory interests diverge. Other possible costs due to regulatory constraints can include financial costs, such as those associated with hiring accountants and independent auditors to produce and verify financial statements (Engle, Hayes, & Wang, 2007; Holmstrom & Kaplan, 2003), or paying licensing fees or taxes. Finally, constraints can prevent firms from engaging in certain types of activities, though those activities may be important for firms' survival. For example, the U.S. Department of Energy ban on incandescent light bulbs has shut down factories and may threaten firms with closure if they cannot compete with off-shore producers of fluorescent light bulbs, which are more labor intensive to produce than fluorescents (Whoriskey, 2010).

The costs inflicted on firms by regulatory constraints can drive up firms' intent to change the constraints set on their activities. However, given regulatory discretion, not all firms bear constraint costs equally, and in some cases, firms may benefit from high regulatory constraints, especially when competitor firms are the ones bearing the costs (e.g., Khavul, Chavez, & Bruton, 2013). Institutional theorists have suggested that institutions perpetuate the unequal distribution of resources within society, which tends to benefit some firms at the expense of others (e.g., Bourdieu, 1977, 1990). Regulatory constraints may have the same effect. For example, the recent imposition of a ban on the production of incandescent light bulbs will be found to be onerous by the makers of these bulbs, while the makers of fluorescent light bulbs may benefit from the reduced competition. Therefore, firms that possess institutional capabilities but face low regulatory costs may be more likely to deploy institutional capabilities to retract constraints and

reduce competitive pressures.

In summary, the costs associated with regulatory constraints influences firms' deployment of institutional capabilities. Though constraints tend to be durable through time due to their ability to reduce uncertainty, constraints may occasionally compel firms to bear costs that outweigh the benefits. In these instances, firms are more likely to deploy institutional capabilities to expand regulatory constraints. Conversely, firms with institutional capabilities that face low costs would be more likely to use their capabilities to retract constraints.

Hypothesis 2a: Regulatory costs positively moderate the relationship between institutional capabilities and constraint expansion such that the higher the costs a firm faces, the stronger the relationship between institutional capabilities and constraint expansion.

Hypothesis 2b: Regulatory costs positively moderate the relationship between institutional capabilities and constraint retraction such that the lower the costs a firm faces, the stronger the relationship between institutional capabilities and constraint retraction.

Framing moderates the relationship between institutional capabilities and constraint expansion/retraction

Firms may develop points of view or preferences for regulatory constraints, independent of the costs associated with these constraints. These points of view constitute the framing firms use to decipher meaning in and form intentions regarding their regulatory environments. Frames enable actors to perceive and evaluate meaning (Goffman, 1974) as well as determine what “should be going on” (Benford & Snow, 2000: 614). Frames work within the firm to disseminate meaning across its members, and these collective, firm-level frames are defined as “the action-oriented sets of beliefs and meanings that inspire and legitimate the activities and campaigns of a social movement organization” (Benford & Snow, 2000, p. 614). While it would be erroneous to suggest that firms have attitudes or opinions, firms are nevertheless characterized by shared frames of meaning, and some firms may develop such frames regarding the regulatory constraints that affect them (Crossan, Lane, & White, 1999).

Frames not only guide the firms' perception and labeling of regulatory constraints as "good" or "bad," through diagnostic framing, they also constitute how firms foresee the future regulatory environment, through prognostic and motivational framing (Markowitz, 2007; Misangyi, Weaver, & Elms, 2008). Firms use diagnostic framing to make explicit the particular ways a regulatory constraint is failing or is weak (Suddaby & Greenwood, 2005). For example, Walter Robb, the co-CEO of Whole Foods, recently announced that his company was going to begin labeling foods that had been genetically modified, stating "The prevalence of [genetically modified foods] in the U.S. paired with *nonexistent mandatory labeling* makes it very difficult for ... consumers to choose non-GMO products." (Hsu, 2013). Robb's comment, and the company's actions (i.e., supporting legislation that would have required the clear labeling of genetically modified foods [Lifsher, 2012]) suggests that Whole Foods has a clearly defined diagnostic frame regarding consumer food regulation. Firms' prognostic framing constitutes their solution to the failed institution (Creed, Scully, & Austin, 2002; Dejean, Gond, & Leca, 2004; Demil & Bensedrine, 2005). It is not enough to disapprove of a regulatory constraint to form dissatisfaction or the intent to change the constraint: firms that have a preferred regulatory outcome or envision an ideal regulatory environment are more likely to form the intent to affect regulatory change.

Firms' motivational framing provides reasons to support the new institutional arrangement (e.g., Misangyi et al., 2008). Motivational framing includes the language used by the firm when communicating its preferred institutional vision to others, whether in disseminating its message throughout the firm or spreading it outside the firm to generate broader social support (e.g., Benford & Snow, 2000). Motivational framing serves to build consensus within the firm to take action as well as to attract other social actors to support an

effort to bring about regulatory change.

Firms differ in the frames they develop, and some firms may possess frames regarding their regulatory environment while others may not. Firms that possess strong regulatory frames are not only more likely to preferences regarding their institutional constraints, but they are also more likely, through motivational framing, to form the intent to obtain a particular regulatory change (Colomy, 1995; Colomy & Rhoades, 1994). The possession of regulatory frames may enhance firms' perception of the costs they or others bear regarding regulatory constraints, link these costs to perceived regulatory inadequacies, and use regulatory change as a means through which to obtain competitive advantage.

Hypothesis 3a: Firms' possession of regulatory framing will positively moderate the relationship between institutional capabilities and constraint expansion.

Hypothesis 3b: Firms' possession of regulatory framing will positively moderate the relationship between institutional capabilities and constraint retraction.

Perceived regulatory complexity moderates the relationship between institutional capabilities and constraint expansion/retraction

Firms' regulatory environments are frequently complex and are characterized by many, overlapping constraints, which may contradict each other (Battilana, Leca, & Boxenbaum, 2009). Scholars have suggested that complex institutional environments create opportunities for regulatory change because the contradictions and ambiguity created by conflicting constraints enable firms to either pit one institution against another, rapidly garner support from other firms facing the same complex environment, or to ignore the constraints altogether (Clemens & Cook, 1999; Oliver, 1991; Sewell, 1992). While such complexity may create objective opportunities to create institutional change (e.g., Seo & Creed, 2002), the effect of perceived regulatory complexity may actually have a negative effect on the likelihood that firms will act on their

constraint dissatisfaction or satisfaction.

The difference in the expected influence of institutional complexity is a consequence of the difference between informal and formal institutions. Firms facing informal institutional pressures tend to comply with these pressures due to a desire for social acceptance and legitimacy (Suchman, 1995; DiMaggio & Powell, 1983). While conformity to informal constraints may be an important prerequisite for obtaining other valuable resources (e.g., Zimmerman & Zeitz, 2002), conformity is generally voluntary. The risks of changing informal institutions are lower compared to changing formal institutions because informal institutions are not enforced through coercion and because firms can frequently rely on alternative sources of legitimacy should they opt to reject or alter a particular informal institution, as they are subject to multiple informal institutions (Demil & Bensedrine, 2005; Greenwood & Suddaby, 2006; Neustadtl & Clawson, 1988).

Conversely, firms are coercively compelled to depend on formal institutions, and regulatory institutions in particular, for survival (Pfeffer & Salancik, 1978). Firms operating within regulated industries must conform to regulatory constraints or face closure (e.g., Oliver, 1991). Firms are also unable to rely on alternative sources of regulatory legitimacy as they would informal sources of legitimacy: if a firm is embedded within the constraints of several regulatory institutions, they may not merely opt out of one and conform more strongly to the others. The existence of multiple regulatory agencies and multiple regulatory constraints amplifies the risk of seeking to manipulate constraints. Changing one regulatory constraint may place it in conflict with the array of other regulatory constraints (Oliver, 1991), and regulatory agencies may therefore seek to reduce firms' influence in highly complex regulatory environments. In response, firms may be compelled to change a wide range of regulatory constraints to facilitate

the change they strongly value. In addition to the risks associated with changing complex regulatory environments, firms possess limited resources compared to the complete array of actors with a stake in regulatory environments. Therefore, firms may be more likely to pursue change when they perceive lower regulatory complexity, which means they will confront fewer actors with possibly divergent interests.

Hypothesis 4a: Perceived regulatory complexity negatively moderates the relationship between institutional capabilities and constraint expansion.

Hypothesis 4b: Perceived regulatory complexity negatively moderates the relationship between institutional capabilities and constraint retraction.

Constraint expansion to access to new opportunities

The conceptualization of institutional entrepreneurship presented in the preceding chapter suggests that formal institutional constraints bisect fields of entrepreneurial opportunities. Within a constraint are opportunities that are legal and socially acceptable, and without the constraint are opportunities that are social acceptable, albeit illegal (cf. Webb et al., 2009). Constraint expansion can be said to occur when constraints are either eliminated or when they permit a wider range of behavior. When constraints expand, more legally viable opportunities become available for exploitation, and firms initially compelled to manipulate their constraints by high regulatory costs (i.e., such as being denied access to a particular customer segment or from producing a particular product or service) will be likely to rapidly expand their products and services or to deliver existing products or services to new customer markets.

Hypothesis 5: Constraint expansion will be positively related to the production of new products or services or delivering existing products and services to new markets.

Constraint retraction to increased value of current opportunities

As described earlier, firms that are satisfied with the regulatory institutions that constrain

them are more likely to engage in manipulation efforts that heighten or toughen the constraints. For these firms, constraints are a critical element of their competitive advantage seeking strategies because it reduces competitive pressures by erecting barriers to entry (Demsetz, 1982). When firms push for licensure requirements or for stronger intellectual property protections, they are attempting to reduce the number of competitors they will face in the market. In terms of entrepreneurial opportunities, such behavior has the effect of making the opportunities they are currently exploiting more valuable. As entrepreneurship scholars have noted (e.g., Eckhardt & Shane, 2003; Shane & Venkataraman, 2000; Short et al., 2010), opportunities tend to decrease in value as a consequence of exploitation. Therefore, fewer firms exploiting a particular opportunity will mean the value of the opportunity will decrease less slowly. Firms that have successfully retracted regulatory constraints should expect to see greater levels of performance without necessarily introducing new products or services or serving new customer segments.

Hypothesis 6: Constraint retraction will be positively related to increased opportunity value, which would be reflected in greater firm returns on current activities.

CHAPTER 4 METHODOLOGY

This dissertation seeks to establish greater understanding regarding the capabilities firms may use to manipulate institutional boundaries in an effort to obtain access to a wider variety of entrepreneurial opportunities or increase the value of opportunities they are already exploiting. This dissertation proposes that the use of these capabilities may constitute some firms' means of obtaining sustainable competitive advantage. This section describes the method used to address the research questions posed in Chapter 1: why do firms opt to manipulate their regulatory environments as a competitive strategy, and what role do institutional capabilities play in facilitating their pursuit of this strategy? First, I will describe the sample of firms used to obtain data. Second, I will describe the qualitative process used to develop the scale used to measure institutional capabilities. Third, I will describe the quantitative survey-based process used to obtain the data used. Lastly, I will describe the process used to determine the appropriate measurement model of institutional capabilities, establish the items used to measure the variables in the study, and report reliabilities.

Sample

Firms are more likely to engage in activities directed toward their formal institutional environments when they operate in highly regulated industries (e.g., Hart, 2001). There is a wide array of highly regulated industries, such as mining and nuclear energy production, healthcare, pharmaceuticals, and finance, and firms within these industries may be more likely to possess the resources and capabilities described in the preceding chapter. The firms used in this dissertation

are commercial banks. There are several different types of banks, including commercial banks, savings banks, or savings institutions (Almandoz, 2012), and each type is constrained in the range of products and services they offer. Commercial banks are permitted to accept deposits, offer business and personal loans (e.g., mortgages or loans that are otherwise backed by assets), and offer a range of basic investment tools, such as bonds, certificates of deposit, and insurance. Commercial bank activities are highly regulated, from even before startup (e.g., they must accumulate enough capitalization before launch to meet state and federal charter requirements) and through even failure (e.g., a commercial bank's failure is controlled by the Federal Deposit Insurance Corporation, which essentially takes over the failed bank and manages the liquidation.) Specifically, banks are regulated at two levels: either state or federal. At startup, banks must acquire either a state charter from the state bank regulators or a national charter from the U.S. Treasury Department (Almandoz, 2012). Throughout their life, banks are regularly inspected and controlled by the state or federal agency that chartered them. Banks must also comply with the rules and regulations of the FDIC and the U.S. Office of the Comptroller of the Currency.

Commercial banks are a highly suitable setting in which to examine the hypotheses presented in the preceding chapter for several reasons. First, their operations are not only highly regulated, but they are subject to regular inspection and interaction with their regulatory agencies, which means they may be more likely to develop routines to facilitate regular institutional interaction. Second, their regulatory environment is currently characterized by rapid and dramatic flux, the introduction of volumes of new statutory and regulatory law (e.g., the Dodd-Frank Bill and the Consumer Protection Agency it created), and increasing discontinuity between state and federal regulation, which contributes to regulatory complexity and ambiguity. Third, many banks (as opposed to hospitals, drug companies, etc.) are under the control of a

founding family or entrepreneur, and many local communities still have locally owned banks. Therefore, it may be possible to more readily and effectively conduct qualitative research in this setting as compared to dealing with national or even international firms. Fourth, the commercial banking industry is regulated by a relatively narrow set of formal institutions – one state-level agency, and three federal-level agencies. Compared to other industries, which might be constrained by many various formal institutions, the formal institutional environment of commercial banks is relatively straightforward. Therefore, bankers may be more aware of the capabilities they develop related to managing their institutional environment.

As this dissertation employs a mixed methodology, comprised of qualitative interviews with a relatively small set of banks, and a two-phase quantitative survey to be sent to a much larger sample of banks, it is necessary to describe the samples used in each portion. For the qualitative portion, a sample of 15 banks have been selected based on their openness to conducting interviews and their availability. In addition to banks, two bank compliance consultants, one located in Oklahoma City and one located in Tulsa, were interviewed in order to capture an ‘outside perspective.’ All banks selected for the qualitative portion are located in Oklahoma. An effort was made to select a variety of banks, based on size, age, whether the bank is state- or federally-chartered, and whether the bank is locally or family owned or is part of a larger banking organization. Table 7 presents the types of banks that were included in the qualitative portion. Selecting banks across these categories will enhance the generalizability of the interview findings to the broader banking industry (Gibbert & Ruigrok, 2010).

Please see Table 7

For the quantitative portion of the dissertation, a much larger sample of commercial

banks is required. The FDIC has six regional offices, and governs banks according to location. I drew a random sample of 500 banks from each regional office, for a total sample of 3,000 banks.

Qualitative procedure – building the measurement instrument

Understanding many of the concepts and relationships described in the preceding chapters requires much richer detail and insight than is provided in existing research, as many of the concepts (e.g., institutional capabilities) and relationships (e.g., the relationship between constraint change and entrepreneurial opportunities) are currently underdeveloped in the literature. Therefore, using qualitative methods, such as interviews, is more appropriate for establishing a more thorough understanding of this dissertation's research questions, especially given that understanding "how" firms manipulate regulatory constraints is a principle concern herein (Gephart, 2004; Pratt, 2009). Specifically, The purpose of conducting field interviews was to validate the institutional capabilities conceptualization presented in Chapters 2 and 3 and develop items to measure institutional capabilities (as well as measures for the moderators presented in Chapter 3). As no previous study had 1) conceptualized institutional capabilities and 2) developed measures to assess institutional capabilities, conducting interviews with banks (and other knowledgeable industry actors) was necessary to support the theory presented herein and was critical to develop survey instruments used later in this study. Scale development follows a three-stage process (Hinkin, 1995): 1) item generation, 2) scale development (i.e., building a survey with generated items, confirming the structure of the measurements, and assessing the reliability of the measurements), and 3) scale evaluation. Stage one of this process was accomplished through conducting interviews, described below. Although I entered the field with a research model and conceptualized constructs already in place, item generation was inductive based on the information gleaned during interviews. Stages two and three are accomplished in

the quantitative portion of this study, where I conduct exploratory and confirmatory factor analyses and reliability tests (stage two) and where I test for the invariance of the measurements across two samples (stage three).

The research model described in the preceding chapter establishes a foundation from which semi-structured interview questions may be built (Gibbert & Ruigrok, 2010). The interview script is included in Appendix 1. Interviews were conducted with 15 commercial banks and two bank compliance consultants.. In order to locate banks for this portion of the study, in June 2013 I contacted the Oklahoma Bankers Association (OBA) and provided them with the types of banks that should be interviewed. Oklahoma-based banks are subject to the same regulatory agencies and rules as all banks in the United States. State-chartered banks, while subject to state banking commission oversight, are also subject to FDIC oversight. Nationally chartered banks and Federal-Reserve member banks are not subject to state oversight at all and are only regulated by national agencies. Therefore, interviewing banks in Oklahoma provides a level of generalizability for all U.S. banks regarding regulatory oversight. Based on these criteria, the OBA provided me with a list of 20 banks to contact. I called each bank, asked to speak with their president or chief compliance officer, and made arrangements to conduct in-person interviews at each bank location. After each interview, I asked if the banker knew any other banks that would be willing to be interviewed.

As the interviews continued through the summer and fall of 2013, I focused on conducting interviews with banks based on capturing a wide variance based on the criteria described above; in particular, I focused on interviewing more small banks and more nationally chartered banks. These banks were not OBA referrals and required cold-calling to secure interviews. Table 7 lists the banks interviewed in chronological order and shows how interviews

were increasingly conducted with smaller, nationally regulated banks, which were under-represented in earlier interviews. Such a “snowball” process may bias the information gleaned during interviews, and indeed, many of the bankers referred to me by the OBA presented a strong interest in discussing regulatory issues from an anti-regulatory viewpoint, but cold-called banks exhibited less extreme viewpoints. Finally, I cold-called two banking compliance consultants in order to establish a more holistic viewpoint of the compliance process: while individual bankers might be able to describe only a narrow range of activities their banks use with regard to their regulatory environment, bank compliance consultants work with dozens of banks in Oklahoma and across the United States and were useful in helping me understand bank practices from a much wider perspective. In this manner, I was able to find 15 banks and two compliance consultants to interview.

For both the qualitative and quantitative portions of this study, I sought interviews (and asked for survey completion) from individuals who were most knowledgeable about banks’ activities related to the regulatory environments. Depending on size and available resources, banks handle regulatory tasks differently. In small banks, this person was almost exclusively the bank president. Small-bank presidents manage the relationships with state and national regulators, handle all communication with regulators, and serve as the primary contact during bank examinations. As banks increase in size, many of the bank tasks related to the regulatory environment are assigned to different individuals: chief operating officers may handle regulatory issues related to deposits and other day-to-day transactions while chief loan officers are responsible for regulatory issues related to fair housing. In even larger banks, many of these duties fall under the oversight of a chief compliance officer. Therefore, I sought interviews with individuals in banks who had the most knowledge related to the concepts under examination in

this study, and the cover letters that accompanied surveys, as well as the surveys themselves, unambiguously stated the purpose of the study.⁷ In these ways, I attempted to ensure that the information obtained from each bank was from the most knowledgeable individual.

Each interview lasted at least one hour, depending on each banker's knowledge and experience regarding their regulatory environments and their bank's activities. The semi-structured interviews followed the script included in Appendix 1. Questions were prepared in advance and were written following the research model in Chapter 3. More specifically, questions were written regarding each construct in the model, and understanding was sought regarding: 1) what are the nature of these constructs within the bank, 2) what activities comprise these constructs, and 3) who within the bank performs these activities? During the course of each interview, follow-up questions and prompts were used to encourage participants to clarify answers (i.e., "such as?" "what do you mean by X?") or to enhance their description (i.e., "could you give me an example of what you just described?" "could you go deeper into that subject?") All interviews were recorded and transcribed. The transcript of all interviews was 170 pages and 101,035 words. The transcript is included in Appendix 3. To analyze the interviews, I inputted them into NVivo and created a set of codes based on the research model presented in Chapter 3, with a code for each variable in the model. With the transcript coded, it was possible to sort the transcript's contents by the construct-specific content addressed. For instance, all responses related to perception capabilities were portioned off and included into a separate document file, all responses related to interaction capabilities were included in a separate file, and so on. With responses sorted by construct, the portioned transcript was more easily used to

⁷ In two instances during the interview portion of this study, it became evident during the course of the interview that the person I was talking to was less knowledgeable about regulatory related bank activities than others in the bank; in both instances, I politely stopped the interview and asked if it was possible to speak with the more knowledgeable individual. Both requests were granted.

generate measurement items. In writing items, I followed recommendations by others to keep items short, write items that relate to only one activity, and include reverse-scored items (Harrison & McLaughlin, 1993; Hinkin, 1998). Below, I have included examples of how subjects' statements led to the development of items for each independent variable and moderator variable:

Perception capabilities:

“When you sit down and read a new promulgated rule, part of that volume of paper they put out is they give you the complete background as to why this law was ever in effect. What the proposal will do. They put it out there for public comment. And this is their take on the public comments. Then they finally get to the guts of what the final rule is. So try to read through all that? And by the time you get down to the new rules? Well, I'm tired. I don't want to read that. So they put out [a] new section – these are the bullet points they are addressing, you need to pay attention; but depending on your banking complexity, some of these rules will apply and some you can brush over.”

Sample Item 1: “*Understanding the ‘Cliff Notes’ of a regulation is good enough.*” (Regulatory agencies will regularly highlight key points in new rules; banking associations also email summaries of regulation changes to subscribing banks.)

Sample Item 2: “*People in my bank are good at quickly understanding which parts of regulation applies to our bank and which don't.*” (Many regulatory rules are product/service oriented; therefore, if a bank does not offer home loans, it may not be subject to certain regulatory oversight.)

Interaction capabilities:

“I take the philosophy of out of sight, out of mind. I stay quite. I come in, I do my job. I figure if they don't hear from me – you know what I mean?”

“You want to be straight forward and very truthful with them. We just try to treat them like anybody else. Like our customers who come in the door.”

“We want them to know our plans, we want them to know where we're going. We give them regular updates on how we're doing, even though they're not asking. Because when we get around to asking, we want them to know how our thoughts developed and how that fits into a logical continuum of what we're doing.”

Sample Item 1: “*Our bank takes an ‘out of sight, out of mind’ approach with regulators.*” (A reverse-coded item. A bank president indicated that too much interaction with regulators can sometimes signal ‘weak management.’)

Sample Item 2: *“We treat regulators like we would treat our customers.”* (The examination process is a major point of contact between banks and regulators. These examinations can be extremely contentious. When examinations are pleasant and both banker and regulator are comfortable with each other, this may facilitate relationship building.)

Sample Item 3: *“People in my bank are proactive and contact regulators before a problem arises.”* (This item is the opposite of the first sample item. These bankers fear appearing ‘weak’ less than they fear poor regulatory or compliance performance.)

Manipulation capabilities:

“CEO actually sits on the ABA government relations board. So he does have more insight and more impact sitting on that board as far as the ABA being a lobbyist for bank interests. So that’s one way that we do that.”

“There’s always a comment period for the new regulation. We write letters, and we give our input. There’s one state that sends more letters than Oklahoma – and look at our population in comparison.”

“Believe me, at every chance, I’m in front of congress, I’m in front of our state representatives and senators. ... I lobby where I can – at the state level, is where I’m most effective – at the federal level, I have to rely on the ABA to do that for me.”

Sample Item 1: *“People in my bank are involved with the governance committee of a state or national banking association.”* (Community banks may not be able to lobby federal-level regulatory agencies; however, they may participate on the boards of national banking associations and influence lobbying in this manner.)

Sample Item 2: *“People in my bank write comment letters on proposed regulation.”* (Proposed regulations are posted at an agency’s web site for a 6-month period, during which anyone is welcome to write critiques. Regulatory agencies may accommodate these critiques in revising and finalizing the new rule.)

Sample Item 3: *“People in my bank visit representatives at the state capitol about banking issues.”* (At the local level, bankers may frequently visit their government representatives. In many cases, bankers are leaders in their communities and might have greater influence through meeting with a state representative or senator.)

Regulatory framing:

“The bank ... saw [regulators] as the enemy. I’ve seen places where – I’ve probably examined places – where it was clear that the employees had been told to not tell the examiners anything. To me, that’s not the way – they’re just people doing their job. They are not the ones making the laws and the regulations. They are just doing their jobs.”

“I experienced the worst exam in my life because my attitude was “You bastards.” I’ve gone through a great change – and in answer to your question, I do believe that they are

here to help. They have a job to do. Their bosses are telling you these are rules set down through Basel or through congress and we are the police, and just like the main street police, they are here to help. They have to uphold the law, but they're here to help you and to guide you through it."

Sample Item 1: *"Regulators are just trying to do their jobs, same as we are."* (A reverse-coded item. Many bankers expressed a belief that regulatory agencies are predatory and seek to harm banks. Therefore, banks that feel regulators just 'have a job to do' may be less likely to possess an overall negative attitude toward regulators.)

Sample Item 2: *"I trust examiners to deal fairly with my bank."* (A reverse-coded item. Measures the belief that regulators consistently enforce the law.)

Regulatory costs:

"The regulatory environment forced us out of making residential real estate loans – for us, we quit offering residential real estate loans primary dwelling in January 2012 because of the requirement that if you charge X percent, and it's considered a high-priced mortgage, then you have to offer or you have to do escrow – or taxes and insurance. Whenever we originate maybe five primary dwelling real estate loans in a year we can't go buy an escrow program to justify the cost. And we were to the point where if we needed to price the loans where we needed to price them, we couldn't lower that rate any lower to offset what we were paying – we gotta make money on the loan side so we can pay out money on the deposit side. ... So we got out of it. Because of the new real estate lending new rules and regs that forced us out of that market, which cost us some potential income."

"We choose not to do home equity loans in Texas. The reason we don't do home equity loans in Texas is because of the incredibly difficult compliance with their Texas laws related to home equity loans. So instead of learning that and managing that, we've chosen not to do that, which limits our opportunity and limits our customers' access."

Sample Item 1: "Regulation prevents us from offering certain products and services to our customers."

Sample Item 2: "Regulation prevents us from meeting customer needs." (These items are very similar and assess the degree to which regulation prevents banks from meeting customer needs. The first quote addresses the financial risk, and the second quote addresses the opportunity costs regulations may create.)

Regulatory complexity:

"One reason we left the OCC was ... one set of examiners would come in, and we were fine. And another would come in, and they would just hammer us on the previous exam. It was just really frustrating."

“These rules come down from Congress and they’re implemented all at the same time. So you have banks that have to comply with them and regulators who have to enforce them, all in the same day. So we’re trying to learn the law and comply with them. They’re trying to learn the law so they can enforce them. Just like in the bank business, you’ve got these regulators, and they have their own different departments, and they all have their different ways of interpretation of the law. So their interpretation of the law could be different than the states or than ours.”

Sample Item 1: “Regulators are consistent in their interpretation and application of regulations.”

Sample Item 2: “There are often differences in how we interpret a regulation and how a regulator interprets a regulation.”

Sample Item 3: “Regulatory enforcement is very subjective.” (These items are also very similar and assess the degree of uncertainty, ambiguity, and complexity in understanding regulation. The first quote addresses the inconsistencies in how enforcing agents understand and apply regulation. The second quote discusses the difficulty banks have in interpreting regulation and arriving at an interpretation that is congruent with regulatory agents’ interpretation).

The complete list of items derived from the interviews is provided in Table 8 and sorts the items by code (i.e., by the research model variable they are intended to measure).

Please see Table 8

To ensure the content validity of the items (Hinkin, 1998), I sent the complete list of items to eight of the bankers who participated in the initial interviews as well as one professor of finance who is familiar with the banking industry and worked as a banking regulator. I asked them to assess the items in terms of validity (i.e., are the items applicable to the day-to-day activities of bankers, are the items broad enough to capture the potential range of activities and phenomena that bankers encounter, and do the items accurately measure the variables in the study). I also asked them to assess the length of the item list and recommend items that could be dropped, and I asked them to suggest rewording items that may be unclear. Finally, I asked them to suggest items that I may have not included. The outcome of this process are the two survey instruments used in the study, which are included in Appendix 2. Stages two and three of

measurement development require quantitative methods and analyzing data obtained through the surveys, which will be described next.

Quantitative procedure – obtaining survey data

The quantitative portion of this study involved a survey-based design to measure the variables within the research model. One drawback of the survey methodology is common method variance (Podsakoff & Organ, 1986). To mitigate the influence of common method variance, I used a number of methodological and statistical techniques, and I describe the first of these here. One methodological technique involves “temporal separation:” instead of measuring all variables of interest in one survey, variable measures are captured by two or more sequential surveys (Podsakoff et al., 2003). By requiring the completion of multiple surveys, temporal separation may 1) reduce situational effects that might exist while a subject completes the survey, 2) reduce the likelihood that previous answers to items may influence how subjects answer subsequent items, and 3) reduce the likelihood that certain events or experiences, which the survey may prompt in subjects’ memories, would influence their answers to all items in all rounds of the surveys. Therefore, I split survey data collection into two phases: the first phase of the survey captured all independent variables and moderators in the research model while the second phase of the survey captured all mediating variables as well as dependent variables.⁸ Approximately one month passed between the receipt of phase 1 surveys and the mailing of phase 2 surveys.

Phase 1 surveys were sent to 2,915 randomly selected commercial banks included in the June 2013 quarterly FDIC reports, which are publically available at the FDIC web site. (An

⁸ The final dependent variables, “access to new opportunities” and “increased value of current opportunities” were also captured using publically available FDIC data and were not included in the surveys. This follows the suggestion of scholars (e.g., Eisenhardt, 1989; Gibbert & Ruigrok, 2010; Yin, 1994) to triangulate data and use multiple sources for data wherever possible.

initial sample of 3,000 were selected, and 85 banks with over \$10 billion in assets and more than 1,000 employees were removed from the sample as these banks operate in a regulatory environment unique to smaller banks.) This FDIC database includes information for all commercial banks in the United States. Using the Dillman Total Design Method (1978) as a guide, I sent surveys, addressed to “Bank President or Chief Compliance Officer,” to all banks accompanied by a cover letter and business reply envelope. One week after the surveys were mailed, a follow-up post card was sent to all banks encouraging them to complete and return the survey. Phase 1 surveys were sent in two waves: 1,500 were mailed in November 2013, and 1,415 were mailed in January 2014. In sum, 377 phase 1 surveys were returned, with 21 survey packets returned due to bad addresses, resulting in a 13 percent response rate. Of these 377 participants, 216 returned phase 2 surveys, for a 57.3 percent response rate. The overall response rate, including both survey phases, was 7.5 percent. The response rate is below the 10 percent threshold reported by others surveying organizational executives (e.g., Alexiev, Jansen, Van den Bosh, & Volberda, 2010; Boon & Hendriks, 2009; Hambrick, Geletkanycz, & Fredrickson, 1993), which can threaten the validity of these results. However, one consequence of a two-phase survey design can include response attrition and is a tradeoff in handling the threat of common method variance. I checked for non-response bias between the total sample and phase 1 respondents and between phase 1 and phase 2 respondents by conducting independent t tests for differences in the number of branches, number of employees, and asset size for each bank. Between the total sample and phase 1 respondents, there were no significant differences (number of branches, $p > .10$; number of employees, $p > .10$; assets, $p > .10$). Between phase 1 and phase 2 respondents, there were no significant differences across number of branches ($p > .10$) and assets ($p > .10$); however, phase 1 respondents employed fewer people than phase 2 respondents

($p < .10$).

Of the 217 respondents who responded to both survey phases, bankers had about 11.4 years of experience in the roles they currently occupy (SD = 8.65 years) (e.g., president, compliance officer, senior vice president, etc.), with about 28.2 years average industry experience (SD = 10.20). About sixty-five percent of respondents listed their role as either “president,” “CEO,” or “vice president;” 25 percent listed their role as “compliance officer” or “chief compliance officer;” the remaining 10 percent listed various roles, including “chief operations officer,” “auditor,” “chief financial officer,” and “chief lending officer.”⁹ Regarding bank characteristics, the average respondent bank had about 5.8 branch offices (SD = 12.744), 69.13 employees (SD = 129.534), and about \$1,112,273 in assets (SD = \$9,796,388) (i.e., value of depository accounts, loans outstanding, bank investments, etc.). Finally, 41 banks were regulated by the Office of the Comptroller of the Currency, 30 by the Federal Reserve, and 146 by the FDIC. (Several respondents failed to provide complete phase 2 surveys, which affected the statistical analyses later in the study. For the constraint expansion model, there were five cases with missing data, and for the constraint retraction model, there were 12 cases with missing data. These cases were removed using listwise deletion. This difference accounts for discrepancies between the information described above and correlation tables presented later.)

With the data collected, it was next appropriate to run the first of two post-hoc statistical checks for common method variance. The first procedure is the Harmon’s single-factor test,

⁹ As stated earlier, the variety of roles and regulatory responsibilities may be a reflection of the variance of bank resources and size: in small banks, the bank president is often the primary point of contact between the bank and the regulatory environment, and in larger banks, regulatory responsibilities may be divided among various individuals within the bank or assigned to a compliance officer. The cover letter that accompanied each survey – as well as the surveys themselves – were unambiguously concerned with banks’ regulatory activities, and individuals responding to the survey would have had to have sufficient knowledge of these activities to answer the items. The generally high reliabilities of the survey measures and the invariance of the items across a split sample, both of which will be described later in this chapter, provide evidence that there was a consistent awareness and knowledge of regulatory activities among respondents.

which determines if most of the variance measured by the survey items can be accounted for with one factor (Podsakoff et al., 2003). To conduct this test, I entered all the items of the survey that measured latent constructs (i.e., perception, interaction, and manipulation capabilities; institutional framing, costs, and complexity) into the factor analysis function in SPSS. I forced SPSS to extract a single, un-rotated factor. The factor accounted for 15.13 percent of variance, which is well below the 50 percent threshold recommended by scholars (e.g., Podsakoff et al., 2003).

Next, I conducted both an exploratory and confirmatory factor analysis to determine the factor structure of the overall measurement model (all independent and moderator variables), including examining whether the institutional capabilities described in the theory section constitute a single construct (i.e., institutional capabilities) or is better measured as three separate constructs (i.e., perception, interaction, and manipulation capabilities). I entered all items measuring the independent and moderator variables into the principle components analysis function of SPSS, using all 380 returned phase 1 surveys. The first step of exploratory factor analysis is to determine how many components – or linear combinations of survey items – should be used to capture the greatest amount of variance. Stevens (2009) describes two often-used techniques: retaining components that have eigenvalues greater than 1 and using a scree-test, or a graphical picture of each component’s eigenvalue, to find the point at which each subsequent component stops accounting for significant additional variance. The results of this initial factor analysis are presented in Table 9 and Figure 3.

Please see Table 9 and Figure 3

As shown in Table 9, 15 components have eigenvalues greater than 1 and would be

retained under the first rule described in Stevens (2009). However, examination of the scree-plot in Figure 3 clearly shows a drop-off in accounted-for variance between components 6 and 7; therefore, due to the scree-test and theoretical considerations, a six-factor measurement model – consisting of perception, interaction, and manipulation capabilities, and measures for regulatory framing, costs, and complexity – may be most appropriate. The next step is to determine how each item correlates, or “loads,” onto the six components. To assess item loadings and improve the interpretability of the components, I split the rotated factor analysis of the independent variables from the analysis for the moderator variables. The reason for doing this is that it may be reasonable to expect the three institutional capabilities to be correlated with each other, while the moderator variables are less likely to be related to each other (e.g., a bank may face a complex regulatory environment without experiencing costs related to that environment). For the independent variable analysis, I used oblique factor rotation (i.e., direct oblimin) in SPSS, which allows the three components to correlate with each other (Stevens, 2009; Pedhazur & Schmelkin, 1991), and for the moderator variable analysis, I used Varimax rotation, which generates three orthogonal factors from the items. For both analyses, to determine which items may be retained, an item must have at least a .40 loading on its primary factor with no cross-loadings greater than .20 (Stevens, 2009). I suppressed all loadings below .20 to ease interpretability. Items were removed singly or in pairs, and the factor analysis was rerun, and this process was completed until the remaining items loaded according to the criteria described above. The initial, un-filtered factor analysis results for the independent variables are presented in Table 10b. Table 10a includes each item code along with its text to facilitate interpretation. I arrived at the final factor solution through the following steps:

- 1) I removed items labeled ICInter1 and ICInter4 as these are interaction capabilities items and were mis-loading on factor 1 with other manipulation capability items. ICInter1 (“I

or others in my bank have a close relationship with the state banking commissioner”) and ICInter4 (“I or others in my bank participate on the advisory boards of regulatory agencies”) stand out from the other interaction items because they describe bankers’ current relationship with regulators whereas the other interaction items tend to describe activities bankers may use related to contacting regulators. Removing first ICInter1 and then ICInter4, I reran the factor analysis. These results are presented in Table 10c.

- 2) I removed ICPercep5, which mis-loaded on the manipulation capabilities factor. ICPercep5 (“My bank regularly sends managers and employees to compliance workshops hosted by trade associations or regulatory agencies”) differs from other perception capabilities items as it describes attending an event whereas the other perception items tend to describe how well bankers come to understand the written content of regulations. Removing ICPercep 5, I reran the factor analysis. These results are presented in Table 10d.
- 3) I removed ICManip5 and ICManip6, as both items had strong cross loadings on two factors. ICManip 5 (“It is possible to negotiate with examiners on compliance issues”) does not necessarily involve regulatory change, and ICManip 6 (“We have found that regulatory boundaries are flexible”) do not necessarily describe a firm capability as much as it does the condition of the regulatory environment. ICManip5 and ICManip6 were removed, and I reran the factor analysis. These results are presented in Table 10e.
- 4) I removed ICManip7 and ICManip8 due to mis-loading on factor 4 in Table 10e. ICManip7 (“On occasion, it is better to act first and seek regulatory approval later”) and ICManip8 (“We don’t always seek regulatory approval before making business decisions”) describe bank activities related to avoiding or shirking regulatory requirements rather than describing regular activities banks may use to change regulatory constraints. ICManip7 and ICManip8 were removed, and I reran the factor analysis. These results are presented in Table 10f.
- 5) I removed ICPercep6 due to a cross-loading on a second factor above the .20 threshold. In Table 10f, ICPercep6 (“People in my bank are good at quickly understanding the intent of new regulations”) cross-loads onto the interaction capability factor. This could be because the item would require bank employees to know regulators well enough to understand the intent of a new regulation. ICPercep6 was removed, and I reran the factor analysis. These results are presented in Table 10g.
- 6) I removed ICPercep9 for loading too low onto factor 3 (below .40) and ICPercep10 for mis-loading on factor 1 in Table 10g. ICPercep9 (“Understanding the ‘Cliff Notes’ (e.g., summaries prepared by trade associations) of a regulation are good enough) and ICPercep10 (“People in my bank are good at quickly understanding which parts of a new regulation apply to our bank and which parts do not”) may differ from the other remaining items that measure perception capabilities because they go beyond the issue of detecting the appearance of new regulations and focus on the content of regulations. ICPercep9 and ICPercep10 were removed, and I reran the factor analysis. These results are presented in Table 10h.

- 7) Lastly, ICInter3 was removed for cross-loading on factor 2 above the .20 threshold, as shown in Table 10h. ICInter3 (“People in our bank are proactive and contact regulators before a problem arises”) may concern an activity that is not related to building relationships with regulators but rather with complying with existing regulation. ICInter3 was removed, and I reran the factor analysis. The final results are presented in Table 10i. The correlation matrix is presented in Table 10j.

Please see Tables 10a through 10j

I next conducted an orthogonal factor analysis of the moderator variables, and the initial rotated results are presented in Table 10k. I arrived at a final factor solution through the following steps:

- 1) I removed InstFrame3 as it cross-loaded on two factors above the .20 threshold, nor did it load on a single factor above the .40 threshold. InstFrame3 (“Banks are overregulated”) differs from the other five regulatory framing items as it describes bankers’ belief about banks and the other items describe bankers’ beliefs about the regulatory environment. InstFrame3 was removed, and I reran the factor analysis. The results are presented in Table 10l.
- 2) I removed InstFrame1 and InstFrame2 because it cross-loads on three factors above the .20 threshold. InstFrame1 (“Regulation ensures that every bank plays by the same rules”) and InstFrame2 (“Regulation is good for the banking industry”) may cross-load because their wording is too broad, compared to other framing items. InstFrame1 and InstFrame2 was removed, and I reran the factor analysis. The results are presented in Table 10m.
- 3) I removed InstComplex14 because it did not load on any factor above the .40 threshold. InstComplex14 (“It is pointless to try to read a regulation – the clarification from our trade associations and other groups tell me what a regulation really means”) may not have loaded because it does not necessarily measure regulatory complexity. Rather, it measures the effectiveness of other banking groups in deciphering regulation. InstComplex14 was removed, and I reran the factor analysis. The results are presented in Table 10n.
- 4) As shown in Table 10n, all items load on their appropriate factors at a level above the .40 threshold. However, several items cross-load on factors above the .20 threshold. I removed each cross-loaded item, starting with the largest cross-loaded item, reran the analysis, and removed the next largest cross-loaded item. Between each step, I assessed whether the factor structure changed significantly (i.e., items that once loaded on one factor now loaded on another factor). No such changes occurred. The final results are presented in Table 10o. Please note that two framing items – InstFrame6 and InstFrame4r

were left in the analysis in order to have enough items to measure regulatory framing. Their loadings were sufficiently high ($> .70$) and their cross-loadings were significantly low ($< .30$) that I determined this solution to be adequate.

Please see Tables 10k through 10o

The next step is to conduct confirmatory factor analysis to address two questions: 1) do these three-factor measurement models fit the data better than 1-factor measurement models? and 2) are the three-factor measurement models invariant across samples? To address both questions, I relied on structural equation modeling in AMOS 20, and I again test the independent variable measurement model separately from the moderator measurement model. For the independent variable measurement model, using the items retained during exploratory factor analysis, which are listed in Table 10j, I specified a 3-factor measurement model in AMOS, with six ‘perception’ items loading onto a latent ‘perception capability’ variable, six ‘interaction’ items loading onto a latent ‘interaction capability’ variable, and four ‘manipulation’ items loading onto a latent ‘manipulation capability’ variable. This model is shown in Figure 4a. The fit for this model was acceptable ($\chi^2 = 261.687$, $df = 101$, $p \leq .001$; $CMIN/df = 2.591$; $RMSEA = .065$; $CFI = .845$; $SRMR = .0584$). A single factor measurement model is presented in Figure 5a, with all items loading onto a single latent variable.

Please see Figures 4a and 5a

The fit for this model is inadequate ($\chi^2 = 632.418$, $df = 104$, $p \leq .001$; $CMIN/df = 6.081$; $RMSEA = .116$; $CFI = .491$; $SRMR = .1069$), and it provides significantly worse fit than the three-factor measurement model ($\Delta\chi^2 = 370.731$, $\Delta df = 3$, $p \leq .001$). Therefore, confirmatory factor analysis supports the three-factor measurement model for institutional capabilities found during

exploratory factor analysis.

For the moderator variable measurement model, using the items retained during exploratory factor analysis, which are listed in Table 10o, I specified a 3-factor measurement model in AMOS, with three ‘framing’ items loading on a latent ‘regulatory framing’ variable, six ‘cost’ items loading onto a latent ‘regulatory cost’ variable, and six ‘complexity’ items loading onto a latent ‘regulatory complexity’ variable. This model is shown in Figure 4b. The fit for this model was low ($\chi^2 = 266.016$, $df = 87$, $p \leq .001$; $CMIN/df = 3.058$; $RMSEA = .074$; $CFI = .886$; $SRMR = .0723$). A single factor measurement model is presented in Figure 5b, with all items loading onto a single latent variable.

Please see Figures 4b and 5b

The fit for this model was worse ($\chi^2 = 671.404$, $df = 90$, $p \leq .001$; $CMIN/df = 7.460$; $RMSEA = .131$; $CFI = .630$; $SRMR = .1029$), and it provides significantly worse fit than the three-factor measurement model ($\Delta\chi^2 = 405.388$, $\Delta df = 3$, $p \leq .001$). Therefore, confirmatory factor analysis supports the three-factor measurement model for the moderator measurement model found during exploratory factor analysis.

As a final step to evaluate the robustness of both three-factor measurement models, I conducted a test of invariance, which seeks to determine the usefulness of the measurement model across different samples. I created two samples by splitting my dataset into two roughly equal halves. Group 1 consisted of all returned phase 1 surveys sent in November 2013 ($N = 204$). Group 2 consisted of all returned phase 1 surveys sent in January 2014 ($N = 176$). Using a macro developed by James Gaskin (Gaskin, 2012) which compares the path estimates between items and latent variables across two groups, I determined which item loadings were

significantly different across Group 1 and Group 2. The results for both models are presented in Table 11 and Table 12. For the independent variable measurement model, shown in Table 11, no items loaded differently across groups, which satisfies the threshold of at least one item for each factor that is not significantly different (Gaskin, 2012). For the moderator variable measurement model, two items, InstFrame5 and InstCost7, loaded significantly different across groups, which also satisfied the threshold.

Please see Tables 11 and 12

With three-factor measurement models established for the independent variables and moderator variables, I next conducted the final check for common method variance, which involves using a common latent factor in structural equation modeling and is used to assess how much common method variance exists in the data. The technique involves creating a single latent variable alongside the total measurement model including all the items and latent variables in the study. Paths are specified between items and the latent variables they measure, and paths are also specified between all items and the common latent factor. The model is run, holding the path coefficients constant, and the resulting coefficient of the paths and all items (which will all be the same as they were held constant) is squared to obtain the percent variance attributable to using a common method (Gaskin, 2012). I included both measurement models in this analysis, which is presented in Figure 6, and the variance in the measurement model due to common method is 2.79 percent.

Please see Figure 6

Measures

Institutional capabilities. Institutional capabilities were measured using a 13-item scale

that measures three factors. The items included were those retained during exploratory factor analysis (unless otherwise noted). All items were measured using a 5-point scale that ranged from 1 (*strongly disagree*) to 5 (*strongly agree*). The five items used to measure perception capabilities included “People in my bank subscribe to and read trade association email alerts about new regulations,” “In my bank, only one person is responsible for being aware of new regulations,” and “My bank regularly sends managers and employees to compliance workshops hosted by trade associations or regulatory agencies.” Interaction capabilities were measured by four items, including “People in my bank feel comfortable calling state or federal regulators to ask questions about compliance,” “People in our bank are proactive and contact regulators before a problem arises,” and “We are familiar with the agents who examine us.” Manipulation capabilities were measured by four items, including “People in my bank visit representatives at the state capitol about banking issues,” “People in my bank write comment letters on proposed regulation,” and “People in my bank speak with regulators about relaxing enforcement of a regulation.” The Cronbach’s alphas were .597 for perception capabilities, .734 for interaction capabilities, and .780 for manipulation capabilities.¹⁰ Individual item scores were summed to create overall scores for each capability type.

Regulatory costs. Regulatory costs were measured using six items developed during the qualitative portion of this study and retained in exploratory factor analysis. All items were measured using a 5-point scale that ranged from 1 (*strongly disagree*) to 5 (*strongly agree*).

Example items include “Regulation prevents us from offering certain products and services to

¹⁰ Scale reliability considerations also played a role in selecting items to include for each measure. For the perception capabilities measure, ICpercep4 and ICpercep8r were dropped, which brought the reliability for this measure up to .597 from .382. For the capabilities measure, ICinter6r, ICinter7r, and ICinter8 were dropped. ICinter3, which had been removed during exploratory factor analysis was added to the scale. The addition of this item brought the measure reliability to .734 from .624. I determined that the added reliability to which this item contributed justified including it in the measure.

our customers,” “Our costs due to regulation are a serious threat to our performance,” and “My bank has discontinued products and services due to regulation.” The Cronbach’s alpha for regulatory costs was .829. Item scores were summed to create an overall regulatory cost score.

Regulatory framing. Regulatory framing was measured using three items developed during the qualitative portion of this study and retained during exploratory factor analysis. All items were measured using a 5-point scale that ranged from 1 (*strongly disagree*) to 5 (*strongly agree*). Example items include “Regulators don’t trust bankers,” “Regulators are receptive to bankers’ concerns,” and “Regulators are just trying to do their jobs, same as we are.” The Cronbach’s alpha for regulatory framing was .717. Individual item scores were summed to create an overall framing score.

Regulatory complexity. Regulatory complexity was measured by 9 items developed during the qualitative portion of this study. All items were measured using a 5-point scale that ranged from 1 (*strongly disagree*) to 5 (*strongly agree*). Example items include “Banking regulation is easy to understand,” “The various banking regulations do not contradict each other,” and “The pace at which new regulation is being proposed is increasing.” The Cronbach’s alpha for regulatory complexity was .817.¹¹ Individual item scores were summed to create an overall complexity score.

Constraint expansion and constraint retraction. Constraint expansion and constraint retraction were measured with seven items and six items respectively, which asked respondents to indicate the number of times they successfully moved regulatory boundaries over the past five years. Constraint expansion was measured with seven items, including “How many times have

¹¹ To enhance scale reliability, three items (InstComplex7r, InstComplex9r, and InstComplex11r) were added and one item (InstComplex13) was dropped from the scale. The inclusion and exclusion of these items, respectively, increased scale reliability from .666 to .817. The items added in this measure were initially dropped due to excessive cross-loadings (see Table 10n). I determined the added measure reliability justified including these items.

you been able to negotiate with examiners to improve a loan rating, “How many times have you been able to contribute to legislative efforts to loosen legal constraints, such as in working with a state or federal legislator,” and “How many times have you been able to obtain regulatory approval to open a new branch or banking location.” Constraint retraction was measured with six items, including “How many times have you been able to attract regulatory attention to the non-compliant activities of your competitors,” “How many times have you been able to halt the implementation of a new law that would have unduly favored your competitors,” and “How many times have you been able to influence regulation, such as through writing comment letters, discussing issues with regulators/lawmakers, or any other approach, so that your competitors’ costs increased.” The Cronbach’s alphas were .710 for constraint expansion and .809 for constraint retraction. The item scores for these measures were summed together to create overall constraint expansion and constraint retraction scores.

New opportunities. Banks’ access to new opportunities was measured by the sum of two items: “How many new products or services have you introduced in the past five years,” and “How many new branches/banking locations have you opened in the past five years.” As opportunities are defined as situations in which new products and services may be introduced to create value (Shane & Venkataraman, 2000), this measure serves as a proxy for banks’ discovery of such situations.

Opportunity value. The dependent variable related to constraint retraction is opportunity value. This study measures opportunity value as the growth rate of the ratio of sales to existing firm activities. Specifically, opportunity value is measured by the five-year growth rate of each firm’s total sales divided by the number of its employees, reported between 2009 and 2013. Similar “sales-per-employee” or “net-income-per-employee” measures have been used in prior

studies examining workforce productivity (e.g., Datta, Guthrie, & Wright, 2005; Huselid, Jackson, & Schuler, 1997). A productivity measure may also be an appropriate measure of opportunity value; measured this way (and in conjunction with controls for firm size and number of new opportunities), increases in productivity occur either when employees' performance improves *or* when firms are able to derive more sales from existing customer bases (i.e., increased opportunity value). Moreover, using "sales-per-employee" rather than "net-income-per-employee" is more suitable for this study because opportunity value likely does not influence internal firm processes and cost structures.

Both "access to new opportunities" and "opportunity value" are lagged five years, while institutional capabilities and the moderator variables measures were not lagged. While this may hamper the ability to draw inferences of causality from the results, theory suggests that organizational capabilities are developed over the long-term and are stable through time (Zollo & Winter, 2002). Therefore, measuring a firm's capabilities in the present time may also reflect the firm's possession of these capabilities over longer periods of time. In addition, while some of the regulatory constraint changes measured in this study may occur over extended periods of time (e.g., writing a comment letter to adapt a proposed rule could take months or years), other changes may take place more quickly (e.g., negotiating with an examiner for an improved loan rating may take effect at the end of a single discussion or examination period, which may last several days or weeks).

Controls. I controlled for a number of individual and firm level variables that could influence the research model. At the individual level, I controlled for respondents' years of experience in the role they play in the bank. Bank presidents and compliance officers may, throughout their careers, have acquired practices, experience, and cognitive abilities at other

banks or in other roles that they transfer to their new roles, which can influence the degree to which banks exhibit institutional capabilities (e.g., Coff & Kryscynski, 2011; Gavetti, 2005). At the firm level, I controlled for bank age (i.e., number of years since the bank was founded), the number of lobbyists a bank employs, and bank size (i.e., the log of the number of branches each bank operates). Age may influence banks' ability to manage their regulatory environment because long-established banks may possess greater legitimacy than newer banks (e.g., Zimmerman & Zeitz, 2002). These banks may have developed long-standing relationships with regulatory agencies and agents, and these relationships may influence how regulatory agencies apply rules, examine bank processes, and receive feedback from banks. As a consequence, these banks may not need to develop capabilities related to actively fostering and managing relationships with regulatory agencies as these relationships might be inherited as a legacy from preceding generations of bank and regulatory decision makers (e.g., Steier, 2001). This study controls for the number of lobbyists and bank size as research suggests these variables may influence firms' ability to achieve regulatory or other political outcomes (e.g., Schuler et al., 2002). Finally, in the constraint retraction models, I control for new opportunities, as described above. This study suggests that banks that successfully retract regulatory constraints may expect to benefit from more valuable opportunities, all else being equal. Therefore, I include this variable to hold the effect of new opportunities constant in analyzing the outcomes of constraint retraction.

Correlation tables, with descriptive statistics and reliabilities, are presented in Tables 13 and 14. The data in Table 13 pertains to all variables included in the expansion model, and the data in Table 14 pertains to all variables included in the retraction model, as these models will be tested separately.

Please see Tables 13 and 14

CHAPTER 5 RESULTS

I used hierarchical regression in SPSS to test all hypotheses. Regression techniques may be more suitable for this study than other techniques, such as structural equation modeling (SEM), for several reasons. First, recent statistical developments in testing mediation and moderated mediation models rely on programs designed and built for regression software. The use of these new statistical approaches is more robust (i.e., lower Type 1 error rates) than earlier techniques developed using regression (i.e., Baron & Kenny, 1986) and replicated in SEM. Second, moderation in SEM is more difficult to conduct than in regression analyses and may be less effective. Specifically, moderation would require splitting the sample in half and testing high and low levels of each moderator separately. SEM is extremely sensitive to sample size, and splitting the sample size of this study in half may render inaccurate results. In all analyses, I included role experience, bank age, number of lobbyists, and bank size as control variables. In analyses related to constraint retraction, I also controlled for new opportunities. In addition, I centered all independent and mediator variables to avoid multicollinearity issues while multiplying variables to test moderation effects (Aiken & West, 1991).

Mediation

Hypotheses 1a and 1b proposed that institutional capabilities would be positively related to constraint expansion and constraint retraction, respectively. Following the factor analyses, I tested the relationship between each type of institutional capability (i.e., perception capabilities, interaction capabilities, and manipulation capabilities) on constraint expansion and constraint

retraction separately. The results of these analyses are presented in Table 15 and Table 16.

Please see Tables 15 and 16

In the constraint expansion model, perception capabilities ($\beta = .156, p < .05$) and manipulation capabilities ($\beta = .266, p < .001$) were positively related to constraint expansion while interaction capabilities were negatively related to constraint expansion ($\beta = -.148, p < .05$), providing mixed support for Hypothesis 1a. In the constraint retraction model, perception capabilities ($\beta = .120, p < .10$) and manipulation capabilities ($\beta = .204, p < .05$) were positively related to constraint retraction while interaction capabilities were not related to constraint retraction, providing mixed support for Hypothesis 1b. Hypothesis 5 proposed that constraint expansion would be positively related to firms' access of new opportunities. This hypothesis is supported ($\beta = .209, p < .001$). Hypothesis 6 proposed that constraint retraction would be positively related to increased value of firms' existing opportunities. This hypothesis is also supported ($\beta = .187, p < .05$).

To test the indirect effects of institutional capabilities on new opportunities and opportunity value through constraint expansion and retraction, I followed the Baron and Kenny (1986) method for testing mediation. This method suggests mediation exists when 1) the independent and mediator variables are significantly related, 2) the independent and dependent variables are significantly related, 3) the mediator and dependent variables are significantly related, and 4) the effect of the independent variables on the dependent variable is weakened by including the mediator variable. Table 15 presents these steps for the constraint expansion model and Table 16 presents these steps for the constraint retraction model.

For the constraint expansion model, Step 1 is satisfied in the results for Hypothesis 1a: the independent variables were significantly related to constraint expansion. Step 2 is satisfied in

the results for Hypothesis 5: constraint expansion was significantly related to new opportunities. Step 3 is satisfied, as shown in the column labeled Step 3 in Table 15: perception capabilities ($\beta = .141, p < .05$), interaction capabilities ($\beta = -.151, p < .05$), and manipulation capabilities ($\beta = .111, p < .10$) were significantly related to new opportunities. Step 4 is satisfied, as shown in the column labeled Step 4 in Table 15: the effects of the independent variables were weaker when the mediator variable, constraint expansion, was included in the model. The effects of perception and interaction capabilities on new opportunities remain significant, suggesting partial mediation, and the effect of manipulation capabilities on new opportunities is not significant, suggesting that the effect of manipulation capabilities is fully mediated by constraint expansion.

To check the significance of the indirect effects of perception, interaction, and manipulation capabilities on new opportunities, I used a bootstrapping approach recommended by Preacher and Hayes (2008). This bootstrapping approach in mediation analyses has been found to have lower Type 1 error rates than either using Sobel tests or the Baron and Kenny method (1986) and is, therefore, a more robust test. Results show that the indirect effects of perception capabilities ($.047, p < .05$), interaction capabilities ($-.043, p < .10$), and manipulation capabilities ($.053, p < .01$), on new opportunities were significant.

For the constraint retraction model, Step 1 is satisfied in the results for Hypothesis 1b: perception and manipulation capabilities were significantly related to constraint retraction, though interaction capabilities was not and was not included in further analysis. Step 2 is satisfied in the results for Hypothesis 6: constraint retraction is significantly related to opportunity value. Step 3 is satisfied, as shown in the column labeled Step 3 in Table 16: perception capabilities ($\beta = .154, p < .05$) and manipulation capabilities ($\beta = .163, p < .05$) were significantly related to opportunity value. Step 4 is satisfied, as shown in the column labeled Step

4 in Table 15: the effects of perception and manipulation capabilities were weaker when the mediator variable, constraint retraction, was included in the model. The effects of perception and manipulation capabilities on opportunity value remained significant, suggesting partial mediation.

To check the significance of the indirect effects of perception and manipulation capabilities on opportunity value, I again used the Preacher and Hayes (2008) method described above. Results show that the indirect effect of interaction capabilities on opportunity value is not significant, but the indirect effects of perception capabilities (.0003, $p < .10$) and manipulation capabilities on opportunity value are significant (.0004, $p < .05$).

Moderation

Hypotheses 2a through 4b propose moderation of the effects of institutional capabilities on constraint expansion and constraint retraction. The results of these analyses are presented in Table 17 (constraint expansion model) and Table 18 (constraint retraction model). Hypothesis 2a

Please see Tables 17 and 18

proposed that high regulatory costs would positively moderate the relationship between institutional capabilities and constraint expansion. The results do not support this hypothesis. Hypothesis 2b proposed that low regulatory costs would positively moderate the relationship between institutional capabilities and constraint retraction. The results do not support this hypothesis. Hypotheses 3a and 3b proposed that regulatory framing would positively moderate the effect of institutional capabilities on constraint expansion and constraint retraction. The results largely do not support these hypotheses. However, as shown in Table 17, manipulation capabilities positively interact with regulatory framing ($\beta = .286, p < .001$). Figure 7 presents the

plot of the interaction between manipulation capabilities and regulatory framing. The figure

Please see Figure 7

shows that when regulatory framing is high, the positive relationship between manipulation capabilities and constraint expansion is stronger than when regulatory framing is low. This result lends partial support to hypothesis 3a. Hypotheses 4a and 4b proposed that regulatory complexity would negatively moderate the relationship between institutional capabilities and constraint expansion and constraint retraction. The results do not support these hypotheses.

Though not hypothesized, I conducted a final analysis to determine whether the indirect effect of manipulation capabilities through constraint expansion on new opportunities was moderated by regulatory framing. This was the only moderated mediation effect tested given it is the only effect that satisfies the conditions necessary to establish moderated mediation. Such moderated mediation effects are examined by determining 1) if the relationship between manipulation capabilities and new opportunities is significant, 2) if the interaction between manipulation capabilities and framing is significantly related to constraint expansion and if the interaction between constraint expansion and framing is significantly related to new opportunities, 3) if constraint expansion is significantly related to new opportunities, and 4) if different indirect effects of manipulation capabilities on new opportunities through boundary expansion existed as a consequence of low or high regulatory framing (Muller, Judd, & Yzerbyt, 2005; Preacher, Rucker, & Hayes, 2007).

Step 1 is satisfied in the analyses presented in Table 15, which shows that manipulation capabilities were significantly related to new opportunities. Step 2 is satisfied in the analyses presented in Table 17. The interaction term of manipulation capabilities and regulatory framing

is significantly related to constraint expansion ($\beta = .286, p < .001$), and the interaction term of boundary expansion and regulatory framing is significantly related to new opportunities ($\beta = -.222, p < .05$). Step 3 is also satisfied in the analyses presented in Table 17. Constraint expansion is significantly related to new opportunities ($\beta = .180, p < .05$). With the first three steps of the moderated mediation satisfied, the final step examines whether the effects of manipulation capabilities on new opportunities through boundary expansion is different across low and high levels of regulatory framing. To satisfy this step, I employed a statistical significance test developed by Preacher et al. (2007). The test assesses the significance for moderated indirect effects on a dependent variable through a mediator. This test recommends measuring an indirect effect's significance at plus one and minus one standard deviation of the moderator variable. Table 19 presents the results of this test, including effect sizes, standard errors, confidence

Please see Table 19

intervals, and significance levels, and it suggests that the effect of manipulation capabilities on new opportunities was stronger and significant (manipulation capabilities = .115, $p < .001$) at higher levels of regulatory framing and insignificant at low levels of regulatory framing. In sum, the moderation hypotheses were not supported, with the exception of the significant moderation of regulatory framing on manipulation capabilities in the constraint retraction model.

Post-hoc analyses

Given that 1) theory suggests interaction capabilities may be an important means through which firms obtain access to the regulatory process and influence constraint change, and 2) the results above suggest interaction capabilities either have no direct effect or a negative direct

effect on constraint change, a post-hoc analysis was conducted in which a moderation effect of interaction capabilities on the use of manipulation capabilities was tested. Theory would suggest that manipulation capabilities might be more effective for firms that are able to rely on close relationships with regulatory actors through deploying interaction capabilities. The model tested is presented in Figure 8 and the results are presented in Tables 20a (i.e., constraint expansion model) and 20b (i.e., constraint retraction model).

Please see Figure 8 and Tables 20a and 20b

The moderation effect of interaction capabilities on manipulation capabilities is positive in the constraint retraction model ($\beta = .186, p < .05$), which provides evidence that interaction capabilities may enhance firms' use of manipulation capabilities. Figure 9 presents this interaction in graphical form. The interaction effect is insignificant in the constraint retraction model, which may suggest, as I describe more thoroughly in Chapter 6, that interaction capabilities may be used as a defensive mechanism against changing industry and market conditions.

CHAPTER 6

DISCUSSION AND CONCLUSION

Institutional entrepreneurship research, to which this study seeks to contribute, has largely neglected DiMaggio's suggestion (1988) that institutional entrepreneurs seek to intentionally change social constraints to obtain favorable outcomes and has instead examined the interactive social processes through which new institutions arise. This study tightly focuses on the relationship between constraint change and "favorable outcomes" (i.e., entrepreneurial opportunities), which may set the stage for future scholars to incorporate more insights from core entrepreneurship theory to help us understand institutional entrepreneurship. In addition, this study developed a capabilities-based explanation for successful institutional change, which may enhance scholarly understanding of the types of work involved in institutional entrepreneurship (e.g., Lawrence & Suddaby, 2006).

The empirical results support the notion that entrepreneurs and firms that develop institutional capabilities, which are defined earlier as routines that are used to perceive, interact with, and manipulate an institutional environment to obtain competitive advantage, are better able to change institutional constraints. The results also support the notion that constraint expansion enables entrepreneurs and firms to capture a greater number of opportunities, while constraint retraction increases the value of opportunities already being exploited. Moreover, through deductive theorization, conducting field interviews and statistical analyses, I demonstrated that at least three types of institutional capabilities exist – perception capabilities, interaction capabilities, and manipulation capabilities – and that these capabilities each have

different effects on institutional constraints and opportunity quantity and value.

Looking more closely at each type of institutional capability, the results showed that perception capabilities had a strong positive direct effect on new opportunities beyond their influence on constraint change. This finding is congruent with entrepreneurship research, which suggests that individuals and firms attune to their external environments may be more likely to discover opportunities (Barringer & Bluedorn, 1999; Tang, Kacmar, & Busenitz, 2012; Valliere, 2013). Entrepreneurs and firms that deploy perception capabilities may be more likely to detect other types of market information, other than just information on the institutional environment, and this additional information may form the basis for opportunity beliefs. The effects of manipulation capabilities on new opportunities, perhaps unsurprisingly, was fully mediated by constraint expansion, as discrete institutional change is the primary objective of deploying manipulation capabilities.

Interestingly, interaction capabilities, while insignificant in the constraint retraction model, were negatively related to constraint expansion and to new opportunities. This negative effect may be due to several factors. First, as described earlier in this dissertation, interaction capabilities are used to obtain access to regulatory agencies and acquire legitimacy with institutional actors (Hillman et al., 1999, 2009). While interaction capabilities may enable firms to acquire access and legitimacy with institutional actors, firms that have acquired this access and legitimacy may maintain their status by continuing to conform to institutional expectations. In this position, firms may be less likely to deploy institutional change tactics, which could risk their position with institutional actors. Second, firms that interact with institutional actors may be motivated, in part, by a desire to reduce risk related to institutional change. Institutions are effective at constraining behavior insofar as they remain constant (North, 1990), and institutional

change can lead to increased costs for actors that are required to conform to these constraints. Therefore, firms that deploy interaction capabilities may be seeking to reduce institutional change (e.g., Oliver & Holzinger, 2008), which would explain the negative relationship this study found between interaction capabilities and constraint expansion.

Third, in addition to using interaction capabilities to protect the institutional status quo, firms may deploy these capabilities to maintain an industry or market status quo (e.g., Crane, 2013; Oliver & Holzinger, 2008). Launching new products and services or opening new locations to serve customers are risky activities, and some firms (e.g., especially traditionally conservative firms, such as banks) may prefer to continue to offer the same products and services rather than risk launching new products and services to react to changing institutional conditions. In addition, for these firms, regulatory institutions serve as a protection against competitors, and they may perceive any expansion of regulatory constraints as potentially leading to increased competition. Following these reasons, firms that face declining performance may be more likely than other firms to use interaction capabilities to protect the institutional and industry status quo, and this might explain the negative relationship found between interaction capabilities and new opportunities.

The study also found that regulatory framing, which is defined as a firm's sets of beliefs regarding institutions, strengthens the relationship between manipulation capabilities and constraint expansion. Firms that perceive regulations and regulatory agencies to be obstructive and detrimental to performance were more likely to make efforts to reduce regulation through constraint expansion. The finding in this study that regulatory framing moderates manipulation capabilities, rather than perception or interaction capabilities, is congruent with existing theory that suggests framing is "action-oriented," which may mean regulatory framing leads to discrete

behaviors to change the regulatory environment (i.e., manipulation capabilities), rather than perceive it or interact with regulatory actors (Benford & Snow, 2000; Misangyi et al., 2008).

Implications

This research presents a number of implications for theory and for practitioners. First, this study is the first to link deliberate institutional change to entrepreneurial outcomes, namely the capture of new opportunities and more valuable opportunities. In so doing, it establishes a foundation from which agency may be reintroduced to the institutional entrepreneurship discussion. Scholars in this area have long been concerned with the paradox of embedded agency: how do actors, who are constrained by institutions, simultaneously influence the institutions that constrain them (e.g., Battilana et al., 2009)? This study examines the *why* of institutional entrepreneurship (i.e., the pursuit of opportunity), which may inform the paradox issue. If entrepreneurs are motivated strongly enough by the prospect of financial gain, they may assume the risks inherent in any institutional change project. Second, by placing the pursuit of entrepreneurial opportunity as the objective of institutional entrepreneurship, this study is among the first to integrate concepts and relationships established within entrepreneurship theory (i.e., opportunity and innovation) (Eckhardt & Shane, 2003; Shane & Venkataraman, 2000; Short et al., 2010) into institutional entrepreneurship. Third, this study contributes to the growing stream of capabilities research examining the different types of capabilities that might exist. This dissertation builds on the foundation established by others (e.g., Bagley, 2008; Oliver & Holzinger, 2008; Crane, 2013) and more thoroughly conceptualizes institutional capabilities, their constituent activities, and empirically measures the effects of these capabilities.

This study suggests that firms pursue regulatory change in order to pursue more opportunities or more valuable opportunities and this pursuit may be a distinguishing

characteristic of institutional entrepreneurs. In other words, institutional entrepreneurs are not motivated to change institutional constraints as the primary objective: in this study, constraint change is linked to another motivation, opportunity. This is congruent with the “motivated propensity” exhibited by entrepreneurs to depict images of the future (Kirzner, 1985), which is the notion that entrepreneurs are able to perceive present inefficient or undervalued uses of resources and determine more valuable applications of these resources in the future. This entrepreneurial motivation is an important, though tacit, component of the research model presented in this paper. It may be possible that a firm could possess the ability to change regulatory constraints without putting this ability to use, as a firm may either not perceive the existence of entrepreneurial opportunities outside a regulatory constraint or a firm may be satisfied with the value it is already extracting from existing opportunities and opt not to bear the additional costs of engaging in potentially costly efforts to change constraints.

Firms may also choose not to deploy institutional capabilities when they are embedded in extremely strong and coercive regulatory environments. Holcomb (2003) suggests that the discovery of opportunities may be shaped by the institutional environment and that some institutions may be so strong and so well-accepted by members of a society that the perception of new and innovative uses of resources may be impossible. In addition to this influence of strong institutional environments on the perception of opportunities, institutional environments may be so strong or so coercive that they discourage attempts at constraint change. This results of this study were found using a sample of firms in the United States; however, the findings may be different if sought in other institutional environments, such as China or other authoritarian regimes, where political activity may be punished by jail time or even stricter sanctions. In these sorts of institutional environments, firms may develop strong capabilities related to perceiving

and interacting with the regulatory environment, while manipulation capabilities remain underdeveloped or even avoided do to the potential of severe legal sanction.

In addition to formal institutional pressures that could prevent the development or use of institutional capabilities, there may be a number of informal institutional pressures involved. As portrayed in Figure 1, opportunities exist on both sides of a regulatory constraint, and opportunities that are outside a regulatory constraint are still embedded within informal institutional constraints. Loosening a regulatory constraint a short distance to capture an opportunity that may have a great deal of social acceptance may be much easier than loosening a constraint far enough to capture an opportunity that has much less social acceptance. For instance, changing a state law that would permit individuals to sell caskets without an undertaker's license may be much easier than seeking a law change that would permit the sale of narcotics. Firms that pursue the latter type of change may encounter both formal and informal institutional pushback, making the change effort much more difficult. Scholars have examined the role of institutional distance, or the difference between one country's set of institutions and another country's set of institutions, and this research may also inform the examination of the differences between formal and informal institutions and the difficulties this may create for firms pursuing regulatory change (cf. Gaur & Lu, 2007; Xu & Shenkar, 2002). The location of opportunities relative to a regulatory constraint depends on their level of broad social acceptance, and future research might examine what opportunity characteristics may influence opportunities' placement relative to formal constraints. Firms that pursue the former type of change may only encounter formal institutional pressures or pressures from competing industries (e.g., undertakers who may have lobbied for licensure requirements to increase barriers to entry), while drawing on broader social approval for the change project (Greenwood et al., 2002; Greenwood & Suddaby,

2006; Misangyi et al., 2008).

This last issue suggests that a broader “zone of legitimacy” may exist in addition to the location of an institutional constraint, which could influence the degree to which firms are able to change institutional constraints. A zone of legitimacy could include all opportunities within a formal institutional constraint as well as a number of opportunities that lie a limited distance outside these constraints. Constraint change within such a zone of legitimacy may be possible, and change efforts outside this zone would be more difficult if not impossible. In addition, future scholars might examine the extent to which firms possess institutional capabilities and how these capabilities influence firms’ ability to effect constraint change, both within and without the zone of legitimacy. The size of the zone of legitimacy may be dependent upon the degree to which a formal institutional constraint is understood or accepted by other formal or informal institutional actors. More specifically, constraints that are poorly understood (such as newly created constraints or very ambiguous constraints) or seen by informal institutional actors as less legitimate may have more potential for change than constraints that are clearly understood and well accepted. The extent to which firms are aware of and consider “zones of legitimacy” before launching any constraint change effort may be a fruitful path for future research.

For practitioners, the results strongly suggest that regulatory constraint manipulation is one path toward better performance. However, these activities, which may be labeled by some as “crony capitalism,” are not positively viewed in the classroom or in the field.¹² The debate about whether regulatory manipulation is inimical to society is one worth having, but the results of this study do support the efficacy of manipulation, if not the social validity. At the very least, this

¹² In several second-phase surveys, which asked bankers to count specific instances in which they moved regulatory constraints, several bankers abstained from answering and instead wrote in the margins that they believed these activities to be unethical.

study suggests that fostering an awareness within the firm of the importance of regulation and of perceiving regulatory change can contribute to performance. In the management and entrepreneurship classroom, little time is spent on discussing the importance of the formal institutional environment to firm performance and less time is spent on discussing strategies to manage this environment. The results of this study suggest that teaching and discussing this topic may have value for future entrepreneurs and firm leaders.

Future directions

Since Oliver (1991) proposed that firms may take a number of strategic postures related to the institutions that constrain them, scholars have focused on explaining the conditions that enable firms to manipulate, avoid, defy, and compromise these constraints. This study, which links constraint change to entrepreneurial opportunity, falls within this stream of research, and it helps establish a foundation on which future research may further explore the relationship between entrepreneurship and institutional change. This study also contributes to this literature by examining the role of institutional capabilities and firms' strategy, and it raises a number of issues that could prove fruitful for further examination. For instance, greater understanding could be sought regarding the origins of institutional capabilities, such as why firms develop these capabilities, and why certain capabilities (e.g., interaction capabilities) may be developed more strongly by one firm but other capabilities (e.g., manipulation capabilities) may be developed more strongly by another firm.

With regard to Oliver's (1991) work, an institutional capabilities perspective may enhance our understanding of when, how, and why firms adopt certain strategic postures related to institutions. According to Oliver, firms may acquiesce, compromise, avoid, defy, or manipulate institutions. Oliver (1991) also outlined the institutional environmental conditions

that may influence firm responses, such as whether there are many conflicting institutional demands on the firm, whether institutional expectations are congruent with firms' goals (cf. Seo & Creed, 2002), and the extent to which institutional pressures are coercive. The institutional capabilities perspective may build on this work and explain why firms may take strategic postures contrary to those suggested by Oliver. For instance, a firm with strong manipulation capabilities may be more willing to assume a manipulation or compromising posture, all else being equal, because they are adept at changing institutional constraints.

Regarding institutional entrepreneurship as described in Chapter 2 of this study, the theory and results presented herein help explain 1) how firms may act as institutional entrepreneurs in formal environments and 2) what discrete activities these entrepreneurs may undertake to influence their institutional environments. As described earlier, and as shown in Table 5, scholars have closely examined the role of institutional entrepreneurs in informal environments and how entrepreneurs create new organizational forms and cultural norms. While this research contributed to the development of the theory in this study, we nevertheless have much less insight regarding how entrepreneurs change formal institutional constraints. Examining how institutional entrepreneurs operate in formal institutional environments, where constraints are more explicit and coercive than in informal institutional environments, may help build a foundation from which scholars can develop a more generalized theory of institutional entrepreneurship.

Capabilities have been defined as high level routines that are central to helping firms acquire competitive advantage (Winter, 2003), and capabilities have often been conceptualized by scholars as routines directly related to firms' production of products and services, such as contracting capabilities (Mayer & Salomon, 2006) or strategic alliance capabilities (e.g., Schilke,

2014). However, the notion of institutional capabilities suggests that one of firms' central concerns may be managing their institutional environments. In understanding how such capabilities develop, scholars may pay particular attention to the conditions in which firms might develop capabilities that are seemingly tangential to their core production of products and services.

Constraint expansion and constraint retraction are presented in this study as mirror activities, in that they may be caused by the same types of activities and that the same capabilities may lead equally to expansion or contraction. However, a firm may not be as ambivalent regarding the decision to pursue constraint expansion versus constraint retraction. Future research could more closely examine how decision makers in firms choose to target constraints for change, how they determine the most appropriate direction for change, and under what conditions do firms decide to pursue either greater number of opportunities or increase the value of opportunities already being exploited.

Capabilities help firms cope with environmental dynamism, which may be defined as the rapidity and unpredictability of market and industry change (Miller & Friesen, 1983). In dynamic environments, products and services are frequently outmoded by competitors' innovation and the development of new technologies (Peteraf, Stefano, & Verona, 2013; Teece et al., 1997). Therefore, firms that are rapidly able to detect and react to these changing conditions, enabled by capabilities, may be more likely to obtain competitive advantage (e.g., Helfat & Peteraf, 2014; Schilke, 2014). However, environmental dynamism has been frequently conceptualized as the extent of changing market conditions and competitor actions rather than changing regulatory environments. In highly regulated industries, such as that examined in this study, products and services may be more homogenous across firms and few innovations are taking place; however,

due to *institutional* dynamism, these firms may nevertheless benefit from developing capabilities not associated at all with the creation and delivery of products and services but rather to protect existing operations and modes of value creation. Though consensus has formed around the notion that dynamism may be related to firms' development of capabilities (e.g., Eisenhardt & Martin, 2000; Peteraf et al., 2013), future scholars may examine how different types of dynamism may influence the development of different types of capabilities.

Nevertheless, this study's findings are congruent with research that suggests capabilities enable firms to cope with rapid and uncertain environmental change. In this study, firms are subject to a multi-layered regulatory environment, in which different regulatory agencies set different, sometimes conflicting, constraints. Moreover, the rapid regulatory change has created extreme uncertainty. While congress passes a law to regulate banks, this law must then be translated into rules, which are instantly and simultaneously promulgated to both regulatory agencies for enforcement and to firms for compliance. The consequence of this process is that regulatory agencies are determining the best means for defining and enforcing the rules while firms are determining the best means for defining and complying with the rules. The outcome is a negotiated regulatory environment, albeit rife with uncertainty, conflicting definitions, conflicting enforcement standards, and conflicting approaches to compliance. In an institutional environment this complex, the pursuit of competitive advantage may be best achieved by firms that are able to control this negotiated process, such as through using institutional capabilities. Other research has found that institutional complexity slows the rate at which firms comply with a new rule (e.g., Raaijmakers, Vermeulen, Meeus, & Zietsma, in press). Therefore, the firm that possesses institutional capabilities may be able to comply more rapidly, which may also contribute to their ability to control the process through which regulation is negotiated and

ultimately enforced.

Lastly, the capabilities perspective has been used to inform transaction cost economics by explaining which transactions firms may internalize (i.e., those for which they possess capabilities) and those which they may leave outside the boundaries of the firm (i.e., those for which they do not possess capabilities) (Argyres, Felin, Foss, & Zenger, 2012; Brahm & Tarzajian, 2014). One might expect that a bank, restaurant, or drilling company would focus on developing capabilities related to the production of customer value, such as the development of products and services, process innovations, and new technologies related to more effectively and more efficiently creating market value. However, an interesting theme arose in the interviews I conducted with bankers, which challenges this expectation. The bankers I interviewed almost unanimously agreed that they spend more time dealing with regulatory issues than with strategic issues. To the extent that they do develop new products and services, these products and services are developed by investment firms outside the bank, vetted by regulatory actors, and ultimately purchased by the bank.¹³ And in the larger banks I visited, the largest departments were the compliance departments, and even functions outside compliance (e.g., tellers, loan officers) were constantly informed by a compliance priority. The question here would be: at what point does a bank cease to be a bank and instead become a compliance mechanism? The notion of institutional capabilities assumes that firms are achieving competitive advantage by managing the regulatory environment, *not* by creating innovative new products and services and *not* by delivering these products and services to customers more efficiently and effectively. Instead, in

¹³ For instance, many small community banks do not have resources sufficient to offer certain products (e.g., home loans, certificates of deposit, money market accounts, etc.). Therefore, they may enter into agreements with mortgage companies or investment firms to offer these products through the local bank. These products are paired with a compliance package (e.g., a regularly updated computer program that local banks use to facilitate the transaction of these products), which is maintained by the outside company.

some industries, competitive advantage may actually be determined by the ability with which firms are able to obtain regulatory access and manipulate regulatory boundaries.

Limitations

This study has a number of limitations. One limitation is the study's empirical focus on the banking industry, which may reduce the generalizability of its findings. The banking industry is highly regulated, and the regulation the industry faces is currently highly dynamic. Though some industries may share the same level of regulation as the banking industry (e.g., health care, nuclear energy, etc.), few, if any, industries are subject to regulatory institutions that are as rapidly changing and expanding as those facing the banking industry. Therefore, we may expect that banks have more fully developed capabilities related to managing their regulatory environment, especially capabilities related to keeping up with rapid and accelerating regulatory change. However, the theory developed in the preceding chapters may nevertheless be applicable to other firms that face regulatory constraints of any degree. Moreover, this study makes no claims to address informal institutions, and whether institutional capabilities, as conceptualized in this dissertation, exist in an informal institutional context is left for future researchers to examine.

The narrow industry focus also has methodological implications, which may also reduce the generalizability of this study. The institutional capability measurement model was developed through interviewing and surveying individuals within the banking industry. Therefore, the items in the survey are tailored to address activities and outcomes specific to the banking industry. Subsequent research, when applying the institutional capabilities scale developed in this dissertation as well as using the constraint change measures, would likely have to adapt many of the items to address new industry contexts.

A second limitation concerns the low sample size, which reduces the statistical power of the study and which can increase the likelihood of Type II error (i.e., the failure to reject the null hypothesis when the null hypothesis is false). For instance, some moderation effects may be relatively small, and these effects could be found to be non-significant in a small sample size study. To mitigate this limitation, I am currently contacting subjects who responded to the first survey but not to the second survey to acquire their response to the second survey, which will increase the sample size available for this study. The final limitation also concerns the empirical portion of this study. The survey I developed was based on deductive theorization and field interviews. While several of the measures produced through this process were very reliable, at least two were not. Perception capabilities and regulatory framing both had Cronbach alphas below the .70 threshold (Kline, 1999). Low reliability of these measures primarily indicates a problem with the survey instrument, which would need to be corrected if ever reused. Low reliability also calls into question the results found through statistical analysis, especially given that perception capabilities and regulatory framing were involved in several supported hypotheses.

Nevertheless, despite these limitations, the model presented in this study may be more broadly applicable to firms facing a wide variety of regulatory challenges. The 2010 passage of the Affordable Care Act (ACA) provides a recent example of how heavily regulated industries may use capabilities to influence and comply with the law. The hospital industry, including national trade associations, supported many of the provisions of the law as it was being debated among lawmakers (medicarenewgroup.com, 2014). For hospitals, the law constituted constraint retraction in that it limited the number of competitors from other industries (i.e., physician-owned clinics and hospitals) that were permitted to exploit the same opportunity: by preventing

the establishment of new physician-owned clinics and hospitals, the ACA served to increase the value of opportunities being exploited by primary-care hospitals. In terms of the capability model presented in this study, perception capabilities likely played a role in how hospitals established causality between the costs they were bearing and the establishment of physician-owned hospitals. Interaction capabilities enabled the hospital industry to create relationships within the lawmaking entities from which they could advocate for constraint change. Manipulation capabilities enabled the industry to propose and pursue the implementation of new law.

However, as the theory presented in chapters 2 and 3 suggests, many different actors may have an interest in formal institutional changes, and as the ACA took shape, other industries, such as the health insurance industry, became involved in the process. The ACA eventually took on many different dimensions that affect many different industries, not all of which are perceived as favorable to the hospital industry. This divergent process is congruent with some institutional entrepreneurship research that suggests any change effort may be diverted as other actors become involved and pursue their own interests. Since its passage, the ACA has been subject to repeal efforts and other modification efforts (i.e., constraint expansion efforts), some of which have been led by industry players. However, as the law has been gradually enforced (i.e., many of its provisions have been phased-in over a period of several years) and much of its enforcement remains ambiguous, these subsequent change efforts have not been effective. The research model in this study would suggest that since the ACA, as a regulatory constraint, is vague, its costs on performance are unclear, and is highly complex, that firms may be hesitant to launch or support new change efforts.

The model may also inform formal institutional changes even in industries that contend with relatively low levels of regulation. As described above, firms that operate in stable

regulatory environments may be less likely to develop capabilities related to changing their regulatory environments (e.g., Peteraf et al., 2013). Moreover, firms that do not have significant interaction with the regulatory environment may be less likely to bear costs related to the environment or develop strong regulatory frames. Therefore, these firms may exhibit less regulatory change behavior because the antecedent conditions, as described in the research model, do not exist to the extent they do in highly regulated industries. Nevertheless, these firms may be motivated to change regulatory constraints in the face of increased competition or when they have identified new opportunities to exploit that lie beyond a particular constraint. Firms in service industries, such as restaurants, hotels, bars, hairdressers, and taxi-cab drivers, are frequently required to meet minimum regulatory requirements, such as the purchase of vendors' licenses, or be open to periodic inspection, such as inspections of kitchen sanitary conditions. As new competitors arise, these firms may attempt to tighten even these minimum constraints. For instance, taxi-cab and limousine drivers, who are required to purchase chauffers' licenses in Oklahoma, have attempted to retract regulatory constraints in order to prevent the entry of unlicensed competitors, such as Uber (i.e, a smartphone app-based taxi service that links consumers with independent drivers).

Conclusion

This dissertation had two objectives: 1) understand why firms pursue regulatory change, and 2) understand why some firms are better at achieving this change than others. To address the first objective, I integrated concepts central to entrepreneurship theory into the institutional entrepreneurship perspective by suggesting that entrepreneurs and firms are motivated to change regulatory constraints while in pursuit of business opportunities. To address the second objective, I drew on the capabilities perspective to conduct a series of field interviews as well as develop

and test a measurement model of institutional capabilities. While I hope that this measurement model may serve as a launching point for future scholars to examine the role of institutional capabilities, the foundation that this dissertation has laid for the examination of institutional entrepreneurship as a phenomenon informed by entrepreneurship theory is very promising. Heretofore, institutional entrepreneurship scholars have largely neglected the insights developed within entrepreneurship theory, but I hope that the potential implications and insights of integrating the two streams of research are clearer as a consequence of this work.

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TABLES

Table 1: Examples of regulated industries and organizations and the agencies that regulate them

Many industries and organizations are regulated by one or more government agencies, whether at the local, state or federal level. As Scott notes (1983: 105), the result is that organizations deal with a "jungle of conflicting requirements at the local level." The Center for Small Government reports that there are at 465 government agencies, many of which supervise many sub-agencies.

Industry	Agencies
Intra-industry regulatory agencies	Social Security Administration Internal Revenue Service Occupational Safety and Health Administration Office of Equal Employment Opportunity
Banking & Finance	Office of the Comptroller of the Currency Treasury Department Federal Depository Insurance Corporation Consumer Protection Agency State-specific banking regulation agencies
Restaurants	State-specific departments of health
Real-estate	Local zoning laws
Healthcare	Department of Health Healthcare accreditation agencies State-specific agencies
Antiochian Orthodox Christian Archdiocese	Canon law
University of Nebraska athletic department	NCAA rules and regulations Big 10 Athletic Conference

Nuclear energy production	International Atomic Energy Administration Department of the Interior Department of Defense
Agriculture	Department of Agriculture Food and Drug Administration Environmental Protection Agency
University biotechnology research programs	National Institutes for Health
Oil and gas	Bureau of Land Management Environmental Protection Agency Bureau of Ocean Energy Development
Airlines	Federal Aviation Administration
Gun manufacturers	Bureau of Alcohol, Tobacco, Firearms and Explosives
Oklahoma public schools	State Department of Education

Table 2: Continuum of Informal to Formal Institutions

Institutional Characteristics	Informal Unwritten Tacit Non-coercive Longer duration	←----->				Formal Written Explicit Coercive Shorter duration
Examples of institutions						
Unwritten contracts					x	
Constitutional amendment						x
Family institutions	x					
Religious traditions	x					
Canon law				x		
Regulatory rule						x
Judicial law					x	
Tribal honor codes		x				
Marriage contracts			x			

Table 3: Types of Institutional Enforcement

	Normative isomorphism		Mimetic isomorphism		Coercive isomorphism
Example Institutions	- Union-backed workplace safety standards		- Industry trend toward franchising		- Regulation limiting hours children may work
	- Nursing association recommendation adoption		- Common adoption of production standards (e.g., TQM, ISO 9000, etc.)		- Laws prohibiting false advertising
	- Use of common, profession-related terminology across organizations (e.g., "assistant," "associate," and "full" professor tend to refer to the same thing across universities)		- Copying competitor strategies		- Interstate speed limits

Table 4: Differentiating between organizations, institutions, and means of institutional transmission

Organizations		Institutions		Means
<i>Accounting firm</i>		Relationships between junior and senior firm members		Organizational flow chart
<i>Oklahoma Department of Health</i>		Food quality standards		Regular inspections
<i>Family</i>		Spousal roles		Popular media
<i>Department of Public Safety</i>		Driving laws		Stripes on the road
<i>Newspaper</i>		Standards for grammar, usage, punctuation, etc.		Style guide
<i>Catholic Church</i>		Regard for priesthood		Clerical garb
<i>Military</i>		Chain of command		Uniform insignia

Table 5: Journal-published research conducted on institutional entrepreneurship since 2000

This table lists articles published in the past 13 years that either included institutional entrepreneurship in the title or abstract.

Author(s)	Journal	Year	Title	Institutional issues considered	Contribution
Pacheco, D.F., York, J.G., Dean, T.J., & Sarasvathy, S.D.	Journal of Management	2010	The coevolution of institutional entrepreneurship: A tale of two theories	Compared institutional theories based in economics and sociology	In examining the components and focuses of the two theoretical foundations, make suggestions regarding integration of the two, such as in incorporating a greater understanding of property rights into the sociological tradition, in determining under which conditions entrepreneurs may prefer to enhance formal or informal institutions, and establishing a greater understanding regarding the influence that institutional change may play in entrepreneurial activity.
Levy, D., & Scully, M.	Organization Studies	2007	The institutional entrepreneur as modern prince: The strategic face of power in contested fields	Organizational fields and power	Conceptualizes the role of institutional entrepreneur as a powerful actor who is able to understand the interests at stake in an organizational field and to manipulate those interests to obtain change.

Khan, F.R., Munir, K.A., & Willmott, H.	Organization Studies	2007	A dark side of institutional entrepreneurship: Soccer balls, child labour and postcolonial impoverishment	Child labor as a social practice	Describes the role that power and framing had in successfully reducing child labor use in soccer ball production, but emphasized that wages decreased and overall family life worsened after the institutional entrepreneurship project.
Lawrence, T.B., & Phillips, N.	Organization	2004	From Moby Dick to Free Willy: Macro-cultural discourse and institutional entrepreneurship in emerging fields	Organizational practices	Describes the various types of discourse used to legitimate the whale-watching industry and the role that institutional entrepreneurs played in facilitating the development of the emergent industry.
Leca, B., & Naccache, P.	Organization	2006	A critical realist approach to institutional entrepreneurship	Embedded agency	In defining institutions as "self-reproducing recurrent patterns of behavior," they attempt to describe the various levels at which interested actors can affect institutional change despite constraints. They argue that action occurs at three levels, and agents play a critical role at the lowest level, whose practices may become adopted at higher levels.

Perkmann, M., & Spicer, A.	Organization Studies	2007	Healing the scars of history': Projects, skills and field strategies in institutional entrepreneurship	Individual change projects; skills required for project success	Institutional entrepreneurship is the production of new organizational forms. Institutional entrepreneurs rely on political, theorization, and framing skills to facilitate the adoption of their new organizational forms.
Tracey, P., Phillips, N., & Jarvis, O.	Organization Science	2011	Bridging institutional entrepreneurship and the creation of new organizational forms: A multilevel model	New organizational forms	Authors argue that institutional entrepreneurs who are adept at bridging institutional forms -- that is, combining the logics of multiple institutional fields -- may facilitate their success.
Zilber, T.B.	Organization Studies	2007	Stories and the discursive dynamics of institutional entrepreneurship: The case of Israeli high-tech after the bubble	Stories and discourse	Institutional entrepreneurs who use stories to link past events to current outcomes, cast actors in various roles, and assign blame, are better able to generate widespread support for their vision of a future institutional arrangement.

Wijen, F., & Ansari, S.	Organization Studies	2006	Overcoming inaction through collective institutional entrepreneurship: Insights from regime theory	Embedded agency	Employs regime theory to explain how multiple, international actors -- rather than a sole actor -- may overcome institutional constraints and affect change. Tactics used include organizing bandwagons, creating implementation mechanisms, finding common ground, and developing incentive structures.
Munir, K.A., & Phillips, N.	Organization Studies	2005	The birth of the 'Kodak Moment': Institutional entrepreneurship and the adoption of new technologies	Technology adoption	Deploying a particular institutional definition -- the "historical accretions of past practices and understandings that set conditions on action" -- these authors describe how Kodak was able to have its camera technology adopted as the standard through discursive tactics, such as through linking the technology to past practices, and creating new roles (i.e., the Kodak Girl).

Child, J., Lu, Y., & Tsai, T.	Organization Studies	2007	Institutional entrepreneurship in building an environmental protection system for the People's Republic of China	Organizational fields	Filling the gap of understanding institutional entrepreneurship in transitioning economies, the authors describe how actors were able to create an agency within China. Specifically, institutional entrepreneurs would capitalize on critical events (e.g., disasters, pollution accidents, trials, and other important milestones).
Dorado, S.	Organization Studies	2005	Institutional entrepreneurship, partaking, and convening	Organizational fields	Describes the various agency orientations (i.e., toward the past, present, or future), and the implications of these orientations on institutional outcomes.
Greenwood, R., & Suddaby, R.	Academy of Management Journal	2006	Institutional entrepreneurship in mature fields: The big five accounting firms	New organizational forms	Addresses the conditions under which highly embedded firms may bring about institutional change, such as when organizations bridge multiple fields, are misaligned with institutional pressures, or are centrally located within fields and are thus aware of alternative institutional arrangements.

Santos, F., & Eisenhardt, K.	Academy of Management Journal	2009	Constructing markets and shaping boundaries: Entrepreneurial power in nascent fields	New organizational forms	Describes the power tactics (i.e., hard and soft) that new firms may use in establishing the boundaries of their firm activities and protect these boundaries from other organizations.
Maguire, S., Hardy, C., & Lawrence, T.	Academy of Management Journal	2004	Institutional entrepreneurship in Emerging fields: HIV/AIDS treatment advocacy in Canada	New social practices	Authors sought to extend knowledge regarding how marginalized actors in emergent fields might bring about institutional change. Specifically, they argued that institutional entrepreneurs who were domain experts, are able to use a variety of tactics to align the interests of a diverse group of actors, and to link new practices to existing practices, will be more likely to find success in their efforts.
Garud, R., Jain, S., & Kumaraswamy, A.	Academy of Management Journal	2002	Institutional entrepreneurship in the sponsorship of common technological standards: The case of Sun Microsystems and Java	Technology adoption	Describes the challenges that Sun Microsystems faced in proposing Java as a technological standard, including the interests of other actors, which are sometimes divergent and opportunistic.

Garud, R., Hardy, C., & Maguire, S.	Organization Studies	2007	Institutional entrepreneurship as embedded agency: An introduction to the special issue	Embedded agency	In their special issue introduction, the authors describe the challenges of institutional entrepreneurship research, such as overcoming the paradox of embedded agency.
Khavul, S., Chavez, H., & Bruton, G.	Journal of Business Venturing	2013	When institutional change outruns the change agent: The contested terrain of entrepreneurial microfinance for those in poverty	New organizational forms	Institutional entrepreneurship is a process that occurs over time and is influenced by ebbs and flows, as different actors challenge the boundaries of the new organizational form.
Wright, A., & Zammuto, R.	Journal of Business Venturing	2013	Creating opportunities for institutional entrepreneurship: The Colonel and the Cup in English County Cricket	New organizational forms	Describes how an institutional entrepreneur was able to use his field position to create opportunities for institutional change. In this instance, repeated failure taught the entrepreneur how to better acquire and deploy resources to affect the change he desired.

Nasra, R., & Dacin, M.	Entrepreneurship Theory and Practice	2009	Institutional arrangements and international entrepreneurship: The state as institutional entrepreneur	New social practices	Describes how Dubai was able to create an economic zone free from the informal institutions of Arab society in order to attract Western businesses. Such decoupling of native and foreign institutions proved effective at stimulating economic growth.
Misangyi, V., Weaver, G., & Elms, H.	Academy of Management Review	2008	Ending corruption: The interplay among institutional logics, resources, and institutional entrepreneurs	New social practices	Describes how institutional entrepreneurs are able to draw upon existing resources and institutional logics to nevertheless affect social change and reduce corruption.

Table 6: Types of activities used in institutional entrepreneurship

Lawrence and Suddaby (2006) describe the various activities used by institutional entrepreneurs in creating, maintaining and disrupting institutions. The information in this table is derived from their work.

Type of activity		Activity	Definition
<i>Creating institutions</i>		Advocacy	The mobilization of political and regulatory support through direct and deliberate techniques of social suasion, with the purpose of redefining the allocation of material resources or social and political capital needed to create new institutional structures and practices.
		Defining	The construction of rule systems that confer status or identity, define boundaries of membership, or create status hierarchies within a field.
		Vesting	The creation of rule structures that confer property rights, and is deployed through the use of government authority.
		Constructing identities	Establishing new relationships between actors and the fields in which the actor operates, such as the creation of professions.
		Changing normative assumptions	Re-making the connections between sets of practices and the moral and cultural foundations for those practices.

		Constructing normative networks	Building interorganizational connections through which practices become normatively sanctioned and which form the relevant peer group with respect to normative compliance, monitoring, and evaluation.
		Mimicry	Leveraging existing sets of taken-for-granted practices, technologies, and rules, and associating them with the new in a way that eases adoption.
		Theorizing	The development and specification of abstract categories and the elaboration of chains of cause and effect, which includes the naming of new concepts and practices so that they might become part of the cognitive map of the field.
		Educating	Equipping actors with the skills and knowledge necessary to support the new institution, such as the institutionalization of Edison's light bulb, which required that workers be trained how to install and operate electronic infrastructure.
<i>Maintaining institutions</i>		Enabling work	The creation of rules that facilitate, supplement and support institutions, such as creating authorizing agents or new roles needed to carry on institutional routines or acquiring resources that ensured institutional survival.

	Policing	Ensuring compliance through enforcement, auditing, and monitoring.
	Deterrence	Creating the threat of coercion to inculcate the conscious obedience of institutional actors.
	Valorizing and demonizing	The provision for public consumption of especially positive and especially negative examples that illustrate the normative foundations of an institution.
	Mythologizing	Emphasizing positive or negative examples from the past to establish the normative foundations of an institution, such as through glorifying an organization's history.
	Embedding and routinizing	Maintaining and reproducing institutions through the stabilizing influence of embedded routines and repetitive practices such as training, education, hiring and certification routines and ceremonies of celebration.
<i>Disrupting institutions</i>	Disconnecting sanctions/rewards	Removing the incentives for engaging in established practices
	Disassociating moral foundations	Typically exhibited by the gradual undermining of the normative foundation of institutions. For example, the practice of permanent employment in Japan was overturned through indirect means, such as hiring freezes.

		Undermining assumptions and beliefs		Removing the costs of moving away from taken-for-granted patterns of practice, technologies or rules, such as through facilitating new ways of acting that replace existing templates or decreasing the perceived risks of innovation and differentiation.
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Table 7: Characteristics of banks interviewed

Bank	Charter	Charter date	Family owned?	Reg. Agency	No. Employees
No. 1	State	1923*	Yes	FDIC	75
No. 2	State	2007	No	FDIC	66
No. 3	State	1922	Yes	FDIC	15
No. 4	State	1896	Yes	Federal Reserve	54
No. 5	National	1894	No	OCC	351
No. 6	State	1923	No	Federal Reserve	37
No. 7	State	1931	No	FDIC	128
No. 8	State	2007	No	FDIC	46
No. 9	State	1988	No	FDIC	130
No. 10	State	2005	Yes	FDIC	24
No. 11	National	1984	No	OCC	66
No. 12	State	1902	Yes	FDIC	6
No. 13	National	1919	Yes	OCC	4
No. 14	National	1901	No	OCC	8
No. 15	State	1918	Yes	Federal Reserve	7

* Bank No. 1, which is a startup bank, purchased an existing bank charter in 2009 rather than pursue a new charter.

Note. OCC stands for the "Office of the Comptroller of the Currency," which is a national bank regulator.

Table 8: Survey items derived from interviews

An asterisk denotes a reverse-coded item.

Items retained for the final survey are marked in bold.

Perception capabilities

Strongly disagree to strongly agree

- 1) **People in my bank regularly subscribe to and read trade association email alerts about new regulations.**
- 2) ***In my bank, only one person is responsible for being aware of new regulations.**
- 3) **In my bank, each manager is responsible for being aware of regulatory changes that pertain to their department.**
- 4) The people in my bank discuss regulatory changes with each other as soon as they are announced.
- 5) **People in my bank regularly read the text of new banking laws and regulations.**
- 6) **My bank regularly sends managers and employees to compliance workshops hosted by trade associations.**
- 7) My bank regularly sends managers and employees to conferences hosted by regulatory agencies.
- 8) My bank subscribes to and reads email alerts or other notifications from compliance consultants.
- 9) **People in my bank are good at quickly understanding the intent of a new regulation.**
- 10) **People in my bank are good at quickly understanding which parts of regulation applies to our bank and which don't.**
- 11) **Upper management in my bank is aware of and takes interest in regulatory changes.**
- 12) ***To operate effectively, people in my bank need to have detailed understanding of every regulation.**
- 13) **Understanding the "Cliff Notes" of a regulation is good enough.**

Interaction capabilities

Strongly disagree to strongly agree

- 1) **The chief compliance officer in my bank has a close relationship with the state banking commissioner.**
- 2) The chief compliance officer in my bank has a close relationship with federal banking regulators.
- 3) **People in my bank feel comfortable calling the state and federal regulators to ask questions about compliance.**
- 4) **People in our bank are proactive and contact regulators before a problem arises.**
- 5) **I or others in our bank participate on the advisory boards of regulatory agencies.**
- 6) I or others in our bank regularly attend conferences hosted by regulatory agencies.
- 7) Contacting regulators is a good way to clarify an ambiguous regulation.
- 8) **We are familiar with the regulatory agents who examine us.**

- 9) **There is not likely to be a familiar face on the next exam team.***
- 10) People in our bank try to foster personal relationships with regulators.
- 11) **Our bank takes an 'out of sight, out of mind' approach with regulators.***
- 12) People in our bank try to minimize contact with regulators.*
- 13) If the regulator knows you, they are more likely to cut you slack in an examination.
- 14) **We treat regulators like we would treat our customers.**
- 15) **It is OK to email a regulator about a problem the bank encounters.**
- 16) **It is OK to call a regulator about a problem the bank encounters.**

Manipulation capabilities

Strongly disagree to strongly agree

- 1) People in my bank work with our state trade association to kill bad legislation.
- 2) **People in my bank visit representatives at the state capital about banking issues.**
- 3) People in my bank travel to Washington to lobby congressmen about banking issues.
- 4) **People in my bank write comment letters on proposed regulations.**
- 5) **People in my bank are involved with the governance committee of a state banking association.**
- 6) **People in my bank are involved with the governance committee of a national banking association.**
- 7) People in my bank speak with regulators about changing regulations.
- 8) People in my bank speak with regulators about relaxing the enforcement of a regulation.

Regulatory Complexity

Strongly disagree to strongly agree

- 1) **Banking regulation is easy to understand.***
- 2) **The various banking regulations do not contradict each other.***
- 3) **Banking regulation was written by people familiar with how banking works.***
- 4) **Regulators are consistent in their interpretation of regulations.***
- 5) Regulators are consistent in their application of regulations.*
- 6) Regulators at the state and federal agencies are on the same page.*
- 7) **New regulations are very frequently proposed.**
- 8) Every bank plays by the same rules.*
- 9) People in my bank are very familiar with regulatory requirements.*
- 10) **The pace at which new regulation is being proposed is accelerating.**
- 11) **Regulation takes into account the real world.***
- 12) **There are often differences in how we interpret a regulation and how a regulator interprets the regulation.**
- 13) Regulators do a good job keeping up with regulatory changes.*
- 14) Compliance examiners tell me one thing and safety and soundness examiners tell me another.*
- 15) **The language in which regulations are written is easy to understand.***

- 16) The guidance provided by regulatory agencies is always useful.*
- 17) **Regulatory enforcement is very subjective.**
- 18) **It is easy to know how to conform to a regulation.***
- 19) Regulatory language is dense and unreadable.
- 20) **Two people can read the same regulation and arrive at different conclusions.**
- 21) **It's impossible to read every regulation that is adopted.**
- 22) Regulations do not address every possible scenario encountered in a bank.
- 23) We rely on third parties (e.g., compliance consultants, attorneys) to tell us what a regulation means.
- 24) **It is pointless to try to sit down and read a regulation – the clarification from our trade associations and other groups tell me what a regulation *really* means.**

Regulatory Costs

Strongly disagree to strongly agree

- 1) **Regulation prevents us from offering certain products and services to our customers.**
- 2) Our customers demand products and services that we cannot offer them due to regulation.
- 3) Highly regulated products and services create more value for customers than less-regulated products and services.*
- 4) Regulation has increased our costs.
- 5) The costs created by regulation are a serious threat to our performance.
- 6) Regulatory requirements make us a better bank.*
- 7) **Our training costs due to regulation have increased dramatically in the past ten years.**
- 8) **Our compliance costs due to regulation have increased dramatically in the past ten years.**
- 9) **We have discontinued certain products and services because we couldn't keep up with the regulatory requirements.**
- 10) Regulatory costs comprise a small portion of our overall expense.*
- 11) **The time I and others spend on regulation takes away from our ability to increase bank revenue.**
- 12) **Our bank's growth is limited mostly by the regulatory environment.**
- 13) The changing regulatory environment plays a major role in influencing our strategic decision making.
- 14) **Regulation prevents us from meeting customer needs.**
- 15) Consumers are hurt by regulatory requirements (e.g., the restriction of overdraft protection fees).

Boundary expansion

How many times, in the past year (five years), have you been able (failed) to:

- 1) **Negotiate with examiners to improve a loan rating?**
- 2) **Halt the implementation of legislation harmful to your industry through lobbying efforts?**

- 3) **Influence proposed regulation by writing comment letters?**
- 4) **Contribute to legislative efforts to loosen legal constraints, such as in working with a state or federal legislator?**
- 5) **Contribute to the efforts of a state or national trade association to defeat bad legislation?**
- 6) **Obtain regulatory approval to open a new branch or banking location?**
- 7) **Obtain regulatory approval to market a new product or service to customers?**
- 8) **Discuss issues with a state or federal regulatory official, which caused him or her to change their attitude toward your bank?**

Boundary retraction

How many times, in the past year (five years), have you been able (failed) to:

- 1) **Attract regulatory attention to the non-compliant activities of your competitors?**
- 2) **Work with state or federal legislators to write law restricting the activities of credit unions or farm bureaus?**
- 3) **Halt the implementation of a new law that would have unduly favored competitors?**
- 4) **Discuss with regulators your concerns regarding "shadow banking," which caused them to change their attitude toward that industry?**
- 5) **Discuss with regulators your concerns regarding credit unions/farm bureaus, which caused them to change their attitude toward that industry?**
- 6) **Influence regulation, whether through writing comment letters or discussing issues with regulators, that increased the costs of your competitors?**

Table 9: Extracted components with eigenvalues greater than 1

Total Variance Explained

Component	Initial Eigenvalues		
	Total	% of Variance	Cumulative %
1	8.322	15.130	15.130
2	4.617	8.394	23.524
3	2.729	4.961	28.485
4	2.400	4.363	32.848
5	2.138	3.887	36.735
6	1.869	3.398	40.134
7	1.591	2.893	43.026
8	1.570	2.855	45.882
9	1.518	2.761	48.642
10	1.430	2.600	51.243
11	1.277	2.322	53.565
12	1.235	2.246	55.810
13	1.214	2.207	58.017
14	1.079	1.962	59.979
15	1.021	1.857	61.836

Table 10a: Item key

To facilitate the interpretation of the following tables, I have included this chart, which matches each item's code with the text of that item.

Item code	Item text
ICpercep1	People in my bank subscribe to and read trade association email alerts about new regulations.
ICpercep2r	In my bank, only one person is responsible for being aware of new regulations.
ICpercep3	In my bank, each manager is responsible for being aware of regulatory changes that pertain to their department.
ICpercep4	People in my bank regularly read the text of new banking laws and regulations.
ICpercep5	My bank regularly sends managers and employees to compliance workshops hosted by trade associations or regulatory agencies.
ICpercep6	People in my bank are good at quickly understanding the intent of new regulations.
ICpercep7	Upper management in my bank is aware of and takes interest in regulatory changes.
ICpercep8r	To operate effectively, people in my bank need to have detailed understanding of every regulation.
ICpercep9	Understanding the "Cliff Notes" (e.g., summaries prepared by trade associations) of a regulation is good enough.
ICpercep10	People in my bank are good at quickly understanding which parts of a regulation apply to our bank and which parts do not.
ICinter1	I or others in my bank have a close relationship with the state banking commissioner.
ICinter2	People in my bank feel comfortable calling state or federal regulators to ask questions about compliance.
ICinter3	People in my bank are proactive and contact regulators before a problem arises.
ICinter4	I or others in my bank participate on the advisory boards of regulatory agencies.
ICinter5	We are familiar with the agents who examine us.
ICinter6r	There is not likely to be a familiar face on the next exam team.
ICinter7r	Our bank takes an 'out of sight, out of mind' approach with regulators.
ICinter8	We treat regulators like we would treat our customers.
ICinter9	It is OK to call or email a regulator about a problem the bank encounters.
ICmanip1	People in my bank visit representatives at the state capitol about banking issues.
ICmanip2	People in my bank write comment letters on proposed regulation.
ICmanip3	People in my bank are involved with the governance committee of a state or national banking association.
ICmanip4	People in my bank speak with regulators about relaxing enforcement of regulation.
ICmanip5	It is possible to negotiate with examiners on compliance issues.
ICmanip6	We have found that regulatory boundaries are flexible.
ICmanip7	On occasion, it is better to act first and seek regulatory approval later.

ICmanip8	We don't always seek regulatory approval before making business-related decisions.
InstFrame1r	Regulation ensures that every bank plays by the same rules.
InstFrame2r	Regulation is good for the banking industry.
InstFrame3	Banks are overregulated.
InstFrame4r	Regulators are receptive to bankers' concerns.
InstFrame5r	Regulators are just trying to do their jobs, same as we are.
InstFrame6	Regulators don't trust bankers.
InstCost1	Regulation prevents us from offering certain products and services to our customers.
InstCost2	Our costs due to regulation are a serious threat to our performance.
InstCost3	Our training and compliance costs due to regulation have increased dramatically in the past ten years.

Table 10b: Rotated IV loadings, initial results

	Factor		
	1	2	3
ICmanip3	.825		
ICmanip1	.814		
ICmanip2	.744		
ICmanip4	.633		
ICinter4	.482		
ICinter1	.438		.223
ICmanip7		.572	
ICpercep7		-.525	
ICpercep2r		-.474	
ICpercep3		-.472	
ICpercep4		-.412	
ICpercep5	.306	-.409	
ICpercep1		-.363	
ICmanip8		.345	
ICpercep9		.336	
ICpercep8r		.214	
ICmanip5		.484	.629
ICmanip6		.511	.605
ICinter5			.605
ICinter2		-.234	.564
ICpercep10			.523
ICpercep6			.484
ICinter9		-.302	.477
ICinter3	.245	-.348	.453
ICinter8			.429
ICinter6r			.348
ICinter7r		-.232	.261

Table 10c: Rotated IV loadings, step 1

	Factor		
	1	2	3
ICinter5	.621		
ICmanip5	.612	.547	
ICinter2	.597		
ICmanip6	.592	.577	
ICpercep10	.533		
ICinter9	.510	-.245	
ICpercep6	.503		
ICinter3	.500	-.308	.208
ICinter8	.447		
ICinter6r	.340		
ICinter7r	.283	-.213	
ICmanip7		.601	
ICpercep7		-.476	.224
ICpercep2r		-.425	
ICpercep3		-.424	
ICpercep4	.216	-.385	
ICmanip8		.379	
ICpercep9		.347	
ICpercep1		-.312	
ICpercep8r			
ICmanip3			.823
ICmanip1			.787
ICmanip2			.755
ICmanip4			.680
ICpercep5		-.357	.368

Table 10d: Rotated IV loadings, step 2

	Factor		
	1	2	3
ICmanip5	.636	.559	
ICmanip6	.616	.585	
ICinter5	.600		
ICinter2	.571	-.220	
ICpercep10	.546		
ICpercep6	.519		
ICinter9	.489	-.266	
ICinter3	.469	-.343	-.237
ICinter8	.436		
ICinter6r	.325		
ICinter7r	.270	-.222	
ICmanip7		.624	
ICpercep7		-.457	-.208
ICpercep2r		-.411	
ICpercep3		-.404	
ICmanip8		.397	
ICpercep4	.216	-.380	
ICpercep9		.343	
ICpercep1		-.305	
ICpercep8r			
ICmanip3			-.822
ICmanip1			-.808
ICmanip2			-.766
ICmanip4			-.697

Table 10e: Rotated IV loadings, step 3

	Factor		
	1	2	3
ICinter2	.726		
ICinter5	.692		
ICinter3	.636	.211	
ICinter9	.612		
ICinter8	.503		
ICinter6r	.446		.217
ICpercep10	.402		
ICinter7r	.398		
ICpercep6	.321		-.220
ICmanip3		.805	
ICmanip1		.795	
ICmanip2		.737	
ICmanip4		.681	
ICpercep7			-.583
ICpercep3			-.561
ICpercep2r			-.540
ICpercep4			-.513
ICpercep8r			.480
ICpercep1			-.460
ICpercep9			.359
ICmanip7		.212	.328
ICmanip8			.311

Table 10f: Rotated IV loadings, step 4

	Factor		
	1	2	3
ICinter2	.728		
ICinter5	.669		
ICinter3	.638	.242	
ICinter9	.621		
ICinter8	.527		
ICinter6r	.415		
ICinter7r	.401		
ICpercep10	.353		-.243
ICmanip3		.824	
ICmanip1		.814	
ICmanip2		.757	
ICmanip4		.666	
ICpercep3			-.618
ICpercep7			-.596
ICpercep2r			-.580
ICpercep4			-.563
ICpercep1			-.489
ICpercep8r			.479
ICpercep6	.286		-.335
ICpercep9			.320

Table 10g: Rotated IV loadings, step 5

	Factor		
	1	2	3
ICinter2	.740		
ICinter5	.670		
ICinter3	.647	.241	
ICinter9	.632		
ICinter8	.528		
ICinter6r	.413		
ICinter7r	.409		
ICpercep10	.334		
ICmanip3		.827	
ICmanip1		.815	
ICmanip2		.753	
ICmanip4		.662	
ICpercep3			-.636
ICpercep2r			-.620
ICpercep7			-.591
ICpercep4			-.546
ICpercep1			-.528
ICpercep8r			.452
ICpercep9			.311

Table 10h: Rotated IV loadings, step 6

	Factor		
	1	2	3
ICinter2	.743		
ICinter5	.667		
ICinter3	.645	-.231	
ICinter9	.637		
ICinter8	.527		
ICinter7r	.427		
ICinter6r	.407		
ICmanip3		-.833	
ICmanip1		-.826	
ICmanip2		-.743	
ICmanip4		-.655	
ICpercep3			-.690
ICpercep2r			-.657
ICpercep7			-.582
ICpercep1			-.582
ICpercep4			-.514
ICpercep8r			.405

Table 10i: Rotated IV loadings, step 7

	Factor		
	1	2	3
ICinter5	.713		
ICinter2	.685		
ICinter9	.619		
ICinter8	.521		
ICinter6r	.500		
ICinter7r	.442		
ICmanip3		-.836	
ICmanip1		-.830	
ICmanip2		-.750	
ICmanip4		-.657	
ICpercep3			-.685
ICpercep2r			-.656
ICpercep7			-.581
ICpercep1			-.566
ICpercep4			-.530
ICpercep8r			.415

Table 10j: Factor correlation matrix

Factor	1	2	3
Interaction capabilities	1.000	-.133	-.176
Manipulation capabilities	-.133	1.000	.201
Perception capabilities	-.176	.201	1.000

Table 10k: Rotated moderator loadings, initial results

	Factor		
	1	2	3
InstCost4	.771	.216	
InstCost6	.764	.209	
InstCost2	.762		
InstCost5	.692		
InstCost1	.653		
InstCost7	.615		.218
InstCost3	.509	.255	
InstCost8	.502		.315
InstFrame3	.354	.307	
InstFrame2r	.320	.292	.280
InstComplex1r		.659	
InstComplex3r		.636	
InstComplex9r	.219	.626	.202
InstComplex12		.599	
InstComplex6	.222	.550	
InstComplex7r	.352	.550	.256
InstComplex11r		.541	.408
InstComplex2r		.532	.223
InstComplex4r		.505	.500
InstComplex5	.272	.488	
InstComplex13		.487	
InstComplex8		.461	.402
InstComplex14		.264	
InstFrame6	.227		.729
InstFrame5r			.681
InstFrame4r	.245		.668
InstComplex10		.308	.476
InstFrame1r	.334	.273	.335

Table 10I: Rotated moderator loadings, step 2

	Factor		
	1	2	3
InstComplex1r	.673		
InstComplex9r	.645	.226	
InstComplex3r	.634		
InstComplex12	.624		
InstComplex11r	.582	.202	.335
InstComplex7r	.565	.351	.231
InstComplex2r	.558		
InstComplex4r	.551		.423
InstComplex6	.528	.224	
InstComplex8	.499		.311
InstComplex13	.489		
InstComplex5	.474	.272	
InstComplex14	.255		
InstCost6	.224	.771	
InstCost2		.769	
InstCost4		.766	
InstCost5		.699	
InstCost1		.668	
InstCost7		.630	
InstCost8		.521	.267
InstCost3	.242	.510	
InstFrame1r	.299	.332	.330
InstFrame2r	.310	.318	.275
InstFrame6		.220	.748
InstFrame5r			.715
InstFrame4r	.224	.228	.702

Table 10m: Rotated moderator loadings, step 3

	Factor		
	1	2	3
InstComplex1r	.675		
InstComplex9r	.648	.226	
InstComplex3r	.637		
InstComplex12	.625		
InstComplex11r	.585	.201	.325
InstComplex7r	.570	.349	
InstComplex2r	.562		
InstComplex4r	.559		.424
InstComplex6	.533	.222	
InstComplex8	.501		.336
InstComplex13	.487		
InstComplex5	.478	.269	
InstComplex14	.249		
InstCost2		.771	
InstCost6	.229	.771	
InstCost4	.201	.765	
InstCost5		.706	
InstCost1		.672	
InstCost7		.633	
InstCost8		.522	.256
InstCost3	.251	.514	
InstFrame6		.235	.760
InstFrame5r			.724
InstFrame4r	.233	.235	.681

Table 10n: Rotated moderator loadings, step 4

	Factor		
	1	2	3
InstComplex1r	.677		
InstComplex9r	.653	.231	
InstComplex3r	.642		
InstComplex12	.614		
InstComplex11r	.590	.205	.315
InstComplex7r	.583	.360	
InstComplex2r	.576		
InstComplex4r	.570		.405
InstComplex6	.537	.229	
InstComplex8	.489		.365
InstComplex5	.481	.275	
InstComplex13	.468		
InstCost2		.771	
InstCost6	.223	.769	
InstCost4		.765	
InstCost5		.703	
InstCost1		.673	
InstCost7		.631	
InstCost3	.264	.525	
InstCost8		.523	.255
InstFrame6		.235	.763
InstFrame5r			.724
InstFrame4r	.249	.242	.663

Table 10o: Rotated moderator loadings, step 5

	Factor		
	1	2	3
InstCost6	.808		
InstCost1	.766		
InstCost2	.754		
InstCost5	.697		
InstCost7	.649		
InstCost8	.610		
InstComplex6		.736	
InstComplex5		.693	
InstComplex3r		.617	
InstComplex12		.586	
InstComplex2r		.533	
InstComplex13		.467	
InstFrame6	.231		.792
InstFrame5r			.786
InstFrame4r	.211	.247	.731

Table 11: Factor structure invariance across two groups: IV measurement model

Item	Factor	Group number 1		Group number 2		z-score
		Estimate	P	Estimate	P	
ICpercep4	<--- Percep	-2.122	0.020	-1.933	0.011	0.158
ICpercep1	<--- Percep	-1.447	0.017	-0.962	0.011	0.681
ICpercep7	<--- Percep	-1.528	0.016	-1.190	0.009	0.432
ICpercep2r	<--- Percep	-2.576	0.016	-1.466	0.013	0.911
ICpercep3	<--- Percep	-1.823	0.021	-2.054	0.008	-0.208
ICinter6r	<--- Interact	0.698	0.127	0.902	0.000	0.389
ICinter8	<--- Interact	1.813	0.008	0.843	0.000	-1.332
ICinter9	<--- Interact	1.945	0.005	1.186	0.000	-1.030
ICinter2	<--- Interact	3.855	0.003	2.009	0.000	-1.345
ICinter5	<--- Interact	2.585	0.004	1.096	0.000	-1.612
ICmanip3	<--- Manip	1.415	0.000	2.066	0.000	1.415
ICmanip2	<--- Manip	1.083	0.000	1.601	0.000	1.399
ICmanip1	<--- Manip	1.361	0.000	2.021	0.000	1.468

Notes: *** p-value < 0.01; ** p-value < 0.05; * p-value < 0.10

Please note for Table 11 and Table 12, in AMOS, one item path estimate for each factor is constrained to 1. Therefore, no differences would exist for these item path estimates across groups, and they are not included in the model.

Table 12: Factor structure invariance across two groups, moderator measurement model

Item	Factor	Group number 1		Group number 2		z-score
		Estimate	P	Estimate	P	
InstCost7	<--- Cost	1.270	0.000	0.837	0.000	-1.724*
InstCost5	<--- Cost	1.466	0.000	1.017	0.000	-1.605
InstCost2	<--- Cost	1.250	0.000	1.231	0.000	-0.071
InstCost1	<--- Cost	1.313	0.000	1.006	0.000	-1.234
InstCost6	<--- Cost	1.706	0.000	1.375	0.000	-1.091
InstComplex2r	<--- Complex	1.144	0.030	0.715	0.019	-0.706
InstComplex12	<--- Complex	1.205	0.014	0.616	0.017	-1.064
InstComplex3r	<--- Complex	1.919	0.010	0.813	0.009	-1.369
InstComplex5	<--- Complex	3.647	0.005	1.626	0.000	-1.478
InstComplex6	<--- Complex	3.264	0.005	1.541	0.000	-1.399
InstFrame5r	<--- Frame	0.843	0.000	0.510	0.000	-2.098**
InstFrame6	<--- Frame	1.106	0.000	0.848	0.000	-1.225

Notes: *** p-value < 0.01; ** p-value < 0.05; * p-value < 0.10

Table 13: Correlation table, means, standard deviations, and reliabilities for constraint expansion model

Variable	Mean	SD	1	2	3	4	5
1. Role experience	11.254	8.642	--				
2. Bank age	87.116	41.967	-.212**	--			
3. No. lobbyists	0.005	0.068	-0.033	0.019	--		
4. Bank size	5.722	12.701	-0.120	-0.057	-0.033	--	
5. Perception cap.	20.963	2.674	-0.017	-0.019	0.052	0.101	0.597
6. Interaction cap.	15.127	2.588	0.047	0.070	0.023	0.020	.205**
7. Manipulation cap.	11.671	3.624	0.043	-0.004	0.044	0.042	.206**
8. Inst. Cost	30.938	5.154	.185**	-0.005	-0.112	-.195**	.173*
9. Inst. Framing	15.377	3.217	0.070	0.093	0.068	-0.059	-0.027
10. Inst complexity	50.498	5.108	0.116	0.047	-0.046	-0.070	0.086
11. Constraint expansion	13.125	14.642	0.024	0.078	0.008	0.070	.174**
12. New opportunities	5.178	4.556	-0.071	0.071	-0.005	.456**	.154*

* $p < .05$. ** $p < .01$

Note. Numbers along diagonal are Cronbach's alphas.

Table 13, continued

6	7	8	9	10	11	12
0.734						
.216**	0.780					
0.033	.257**	0.829				
-.209**	0.078	.322**	0.717			
0.030	0.105	.465**	.318**	0.817		
0.004	.283**	0.114	.228**	0.122	--	
-0.091	0.068	-0.103	0.113	0.072	.162*	--

Table 14: Correlation table, means, standard deviations, and reliabilities for constraint retraction model

Variable	Mean	SD	1	2	3	4	5
1. Role experience	11.220	8.743	--				
2. Bank age	86.930	42.378	-.212**	--			
3. No. lobbyists	0.005	0.069	-0.033	0.019	--		
4. Bank size	5.904	12.972	-0.120	-0.057	-0.033	--	
5. New opportunities	5.289	4.656	-0.071	0.071	-0.005	.456**	--
6. Perception cap.	20.971	2.655	-0.017	-0.019	0.052	0.101	.154*
7. Interaction cap.	15.064	2.530	0.047	0.070	0.023	0.020	-0.091
8. Manipulation cap.	11.559	3.611	0.043	-0.004	0.044	0.042	0.068
9. Inst. Cost	30.754	5.120	.185**	-0.005	-0.112	-.195**	-0.103
10. Inst. Framing	15.289	3.231	0.070	0.093	0.068	-0.059	0.113
11. Inst. Complexity	50.443	5.128	0.116	0.047	-0.046	-0.070	0.072
12. Boundary contraction	3.766	6.579	0.083	0.044	0.113	-0.077	-0.017
13. Opportunity value	-0.038	0.044	.041	.045	-.079	.035	.078

* $p < .05$. ** $p < .01$

Note. Numbers along diagonal are Cronbach's alphas.

Table 14, continued

6	7	8	9	10	11	12	13
0.597							
.205**	0.734						
.206**	.216**	0.780					
.173*	0.033	.257**	0.829				
-0.027	-.209**	0.078	.322**	0.717			
0.086	0.030	0.105	.465**	.318**	0.817		
0.071	.140*	.252**	.156*	0.077	0.084	--	
.150*	.038	.120	.059	-.074	.034	.070	--

Table 15: Regression results for testing mediation, constraint expansion model

Factor and statistic	Constraint expansion	New opportunities	Mediation	
			New Opportunities	
			Step 3	Step 4
Role experience	0.028	0	0.007	0.006
Bank age	0.035	0.053	0.058	0.066
No. of lobbyists	-.002	0.009	0.012	0.003
Bank size	0.032	.473***	.485***	.463***
Capabilities				
Perception	.156**		.141**	.116*
Interaction	-.148**		-.151**	-.127**
Manipulation	.266***		.111*	0.067
Constraint expansion		.209***		.164**
<i>F</i>	3.646**	16.127***	11.464***	11.208***
<i>R squared</i>	0.109	0.277	0.278	0.302
<i>Adjusted R squared</i>	0.079	0.26	0.254	0.275

* $p < .10$. ** $p < .05$. *** $p < .001$

Table 16: Regression results for testing mediation, constraint retraction model

Factor and statistic	Constraint retraction	Opportunity value	Mediation Opportunity value	
			Step 3	Step 4
Role experience	0.147	0.025	0.054	0.034
Bank age	0.02	0.035	0.048	0.045
No. of lobbyists	0.176	-0.119*	-.097	-.122*
Bank size	-.109	-0.016	-.04	-.025
New opportunities	0.051	0.116	0.087	0.08
Capabilities				
Perception	.120*		.154**	.137*
Interaction	0.064		-.084	-.093
Manipulation	.204**		.163**	.135*
Constraint retraction		.187**		.140*
<i>F</i>	4.345***	2.026*	2.138**	2.334**
<i>R squared</i>	0.148	0.057	0.079	0.095
<i>Adjusted R squared</i>	0.114	0.029	0.042	0.055

* $p < .10$. ** $p < .05$. *** $p < .001$

Table 17: Regression results for testing moderation for constraint expansion and new opportunities

With interaction

Factor and statistic	Constraint expansion			New opportunities
	Perception	Interaction	Manipulation	
Role experience	0.015	0.016	-0.001	0.006
Bank age	0.019	0.000	-.016	0.043
No. of lobbyists	-0.015	-.013	-.033	-.012
Bank size	0.038	0.050	0.046	.457***
Perception	0.153**	0.142**	0.131*	.124**
Interaction	-0.110	-0.106	-.097	-.099**
Manipulation	0.256***	0.257***	0.257***	0.098
Inst. Costs	-0.013	0.005	-0.003	-.090**
Inst. Frame	0.151**	0.148**	0.143**	0.123*
Inst. Complexity	-0.006	0.001	-0.013	0.087
Interactions				
Perception X Costs	-0.021			
Perception X Frame	-0.010			
Perception X Complex	0.015			
Interaction X Costs		-.078		
Interaction X Frame		-.030		
Interaction X Complex		-.073		
Manipulation X Costs			-.061	
Manipulation X Frame			.286***	
Manipulation X Complex			-.089	
Expansion				.180**
Expansion X Costs				0.086
Expansion X Frame				-.222**
Expansion X Complex				0.064
<i>F</i>	2.308**	2.712**	3.614***	7.521***
<i>R squared</i>	0.129	0.149	0.189	0.344
<i>Adjusted R squared</i>	0.073	0.094	0.136	0.298

* $p < .10$. ** $p < .05$. *** $p < .001$

Table 18: Regression results for testing moderation for constraint retraction and opportunity value

With interaction

Factor and statistic	Constraint retraction			Opportunity value
	Perception	Interaction	Manipulation	
Role experience	0.145**	0.144**	0.149**	0.026
Bank age	0.023	0.029	0.033	0.037
No. of lobbyists	0.192**	0.187**	0.192**	-0.200**
Bank size	-0.090	-0.118	-0.104	-0.028
New opportunities	0.059	0.068	0.061	0.083
Perception	0.099	0.114	0.118	0.142*
Interaction	0.063	0.070	0.062	-0.099
Manipulation	0.207**	0.193**	0.199**	0.127*
Inst. Costs	0.032	0.042	-0.023	-0.029
Inst. Frame	-0.005	-0.025	-0.018	-0.041
Inst. Complexity	-0.010	-0.013	-0.018	-0.020
Interactions				
Perception X Costs	0.010			
Perception X Frame	-0.094			
Perception X Complex	0.102			
Interaction X Costs		0.039		
Interaction X Frame		-0.054		
Interaction X Complex		0.074		
Manipulation X Costs			0.047	
Manipulation X Frame			-0.090	
Manipulation X Complex			-0.004	
Retraction				0.208**
Retraction X Costs				-0.111
Retraction X Frame				0.064
Retraction X Complex				-0.129
<i>F</i>	2.694**	2.608**	2.578**	1.915**
<i>R squared</i>	0.163	0.158	0.157	0.130
<i>Adjusted R squared</i>	0.102	0.098	0.096	0.062

* $p < .10$. ** $p < .05$. *** $p < .001$

Table 19: Moderated mediated results for manipulation capability on new opportunities across levels of regulatory framing

Moderator	Level	Conditional indirect effect	SE	Lower CI	Upper CI	<i>p</i>
Framing	Low (-SD)	0.0060	0.0295	-0.0824	0.085	> .10
	High (+SD)	0.1148	0.0475	0.0475	0.2918	< 0.001

Table 20a: Post-hoc analysis, constraint expansion model

Factor and statistic	Constraint expansion
Role experience	0.047
Bank age	0.1
No. of lobbyists	-0.001
Bank size	0.071
Capabilities	
Manipulation	.292***
Interaction	-0.066
Manip X Inter	0.031
<i>F</i>	2.854**
<i>R squared</i>	0.097
<i>Adjusted R squared</i>	0.063

* $p < .10$. ** $p < .05$. *** $p < .001$

Table 20b: Post-hoc analysis, constraint retraction model

Factor and statistic	Constraint retraction
Role experience	0.058
Bank age	0.07
No. of lobbyists	0.1
Bank size	-0.071
Capabilities	
Manipulation	0.219***
Interaction	0.100
Manip X Inter	.186**
<i>F</i>	3.988***
<i>R squared</i>	0.131
<i>Adjusted R squared</i>	0.098

* $p < .10$. ** $p < .05$. *** $p < .001$

FIGURES

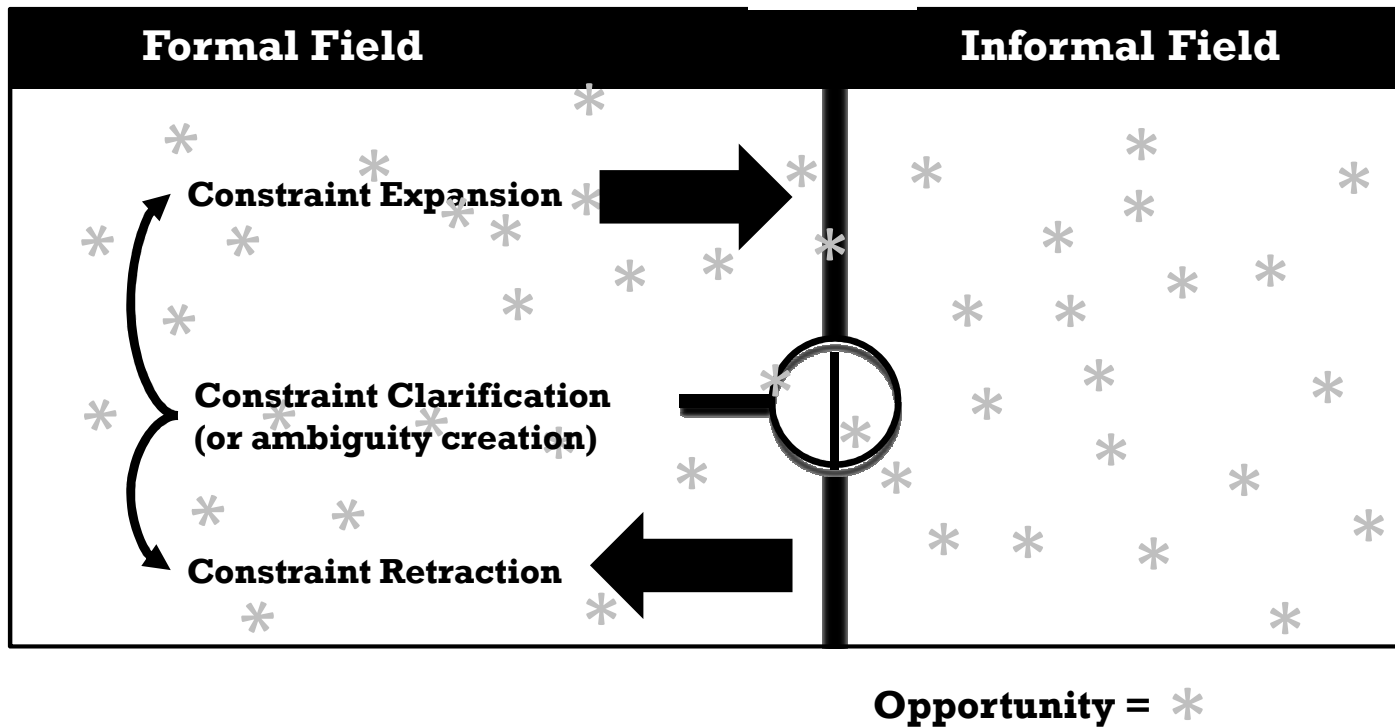


Figure 1: Opportunities and formal institutional constraints

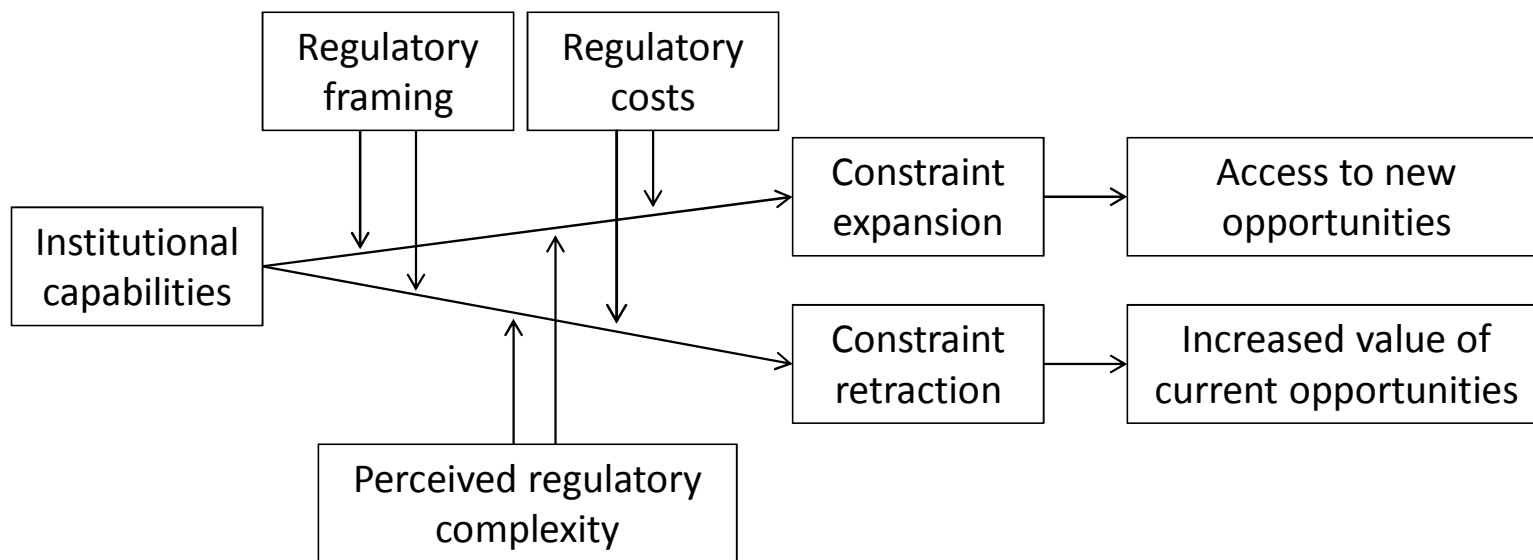


Figure 2: Relationship between institutional capabilities and regulatory change

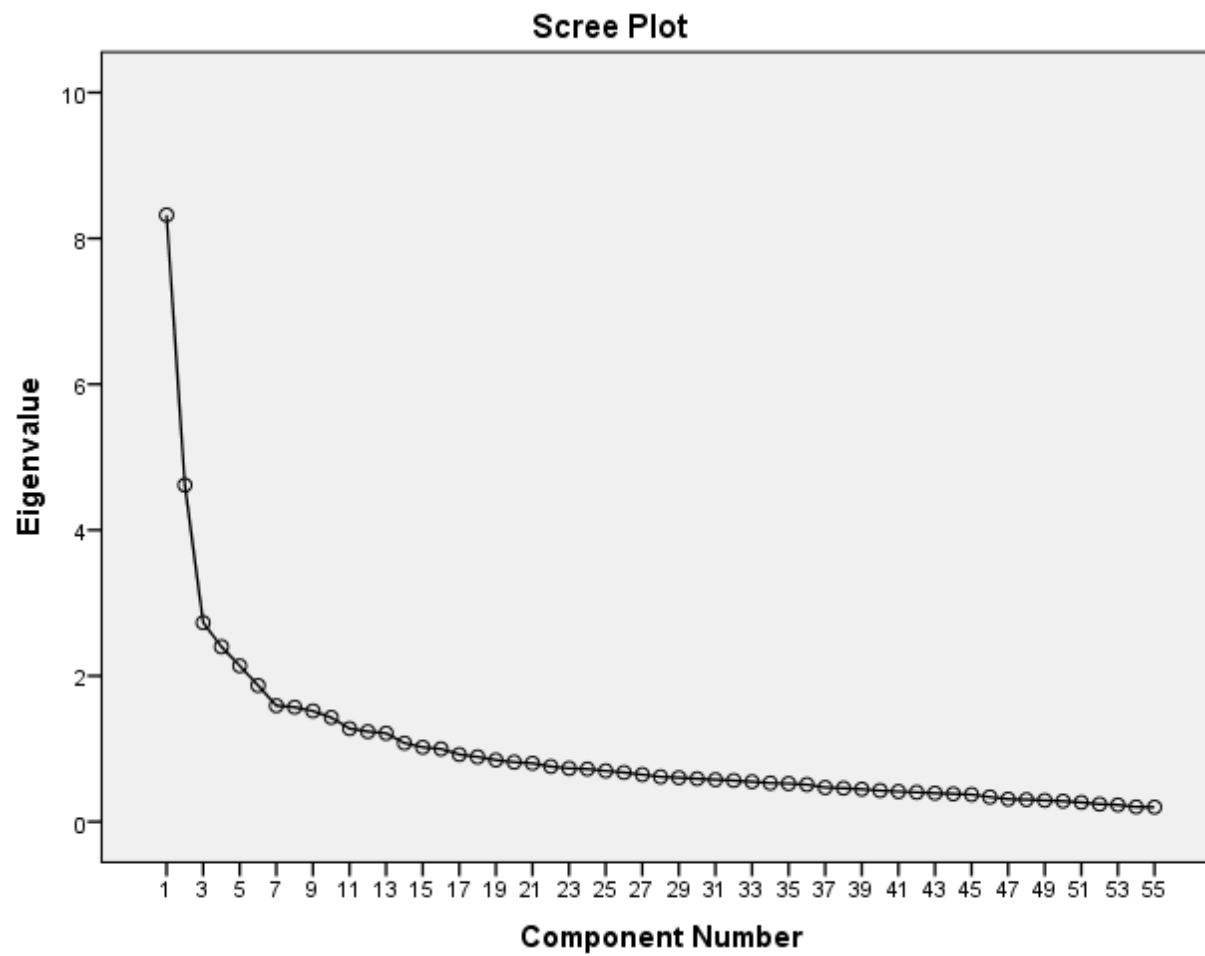


Figure 3: Scree-plot of initial component eigenvalues

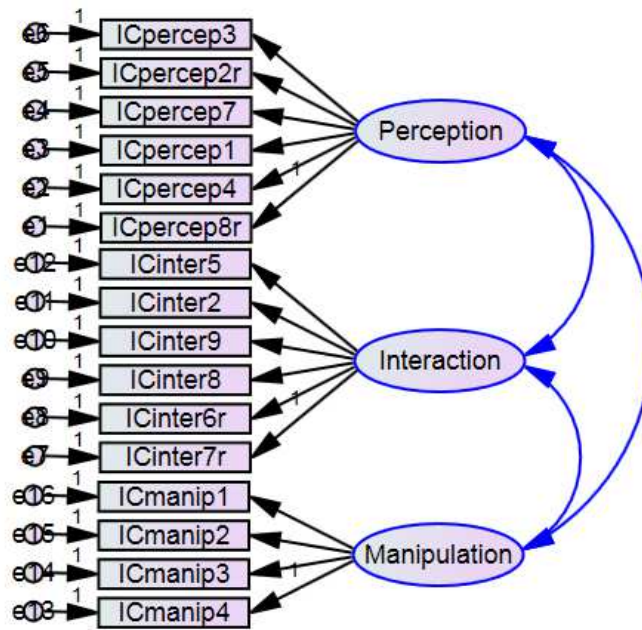


Figure 4a: Three-factor institutional capabilities measurement model

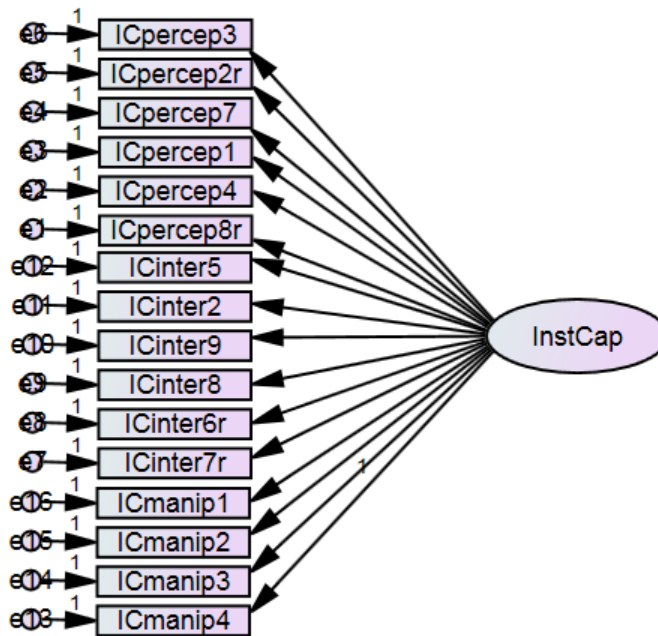


Figure 5a: One-factor institutional capabilities measurement model

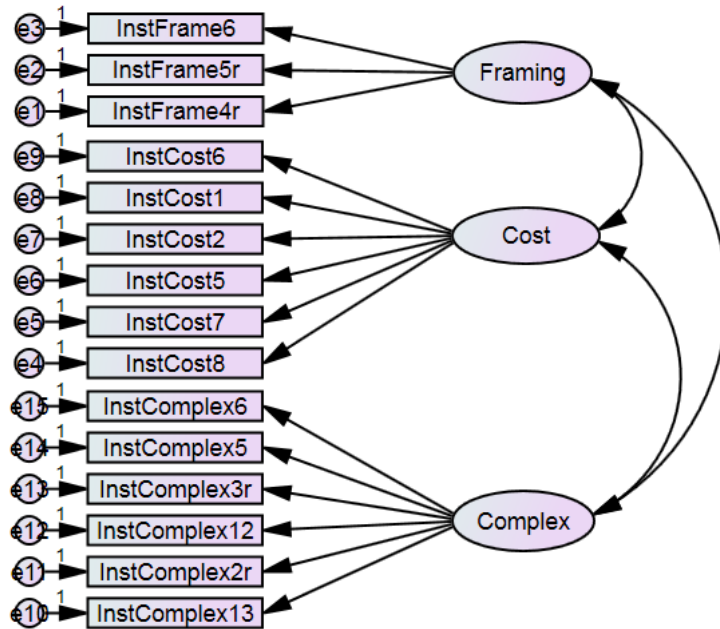


Figure 4b: Three-factor moderator variables measurement model

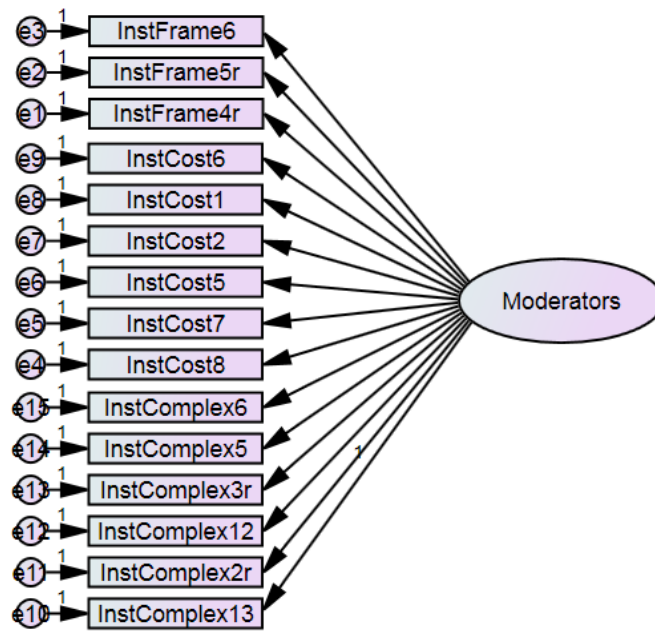


Figure 5b: One-factor moderator variables measurement model

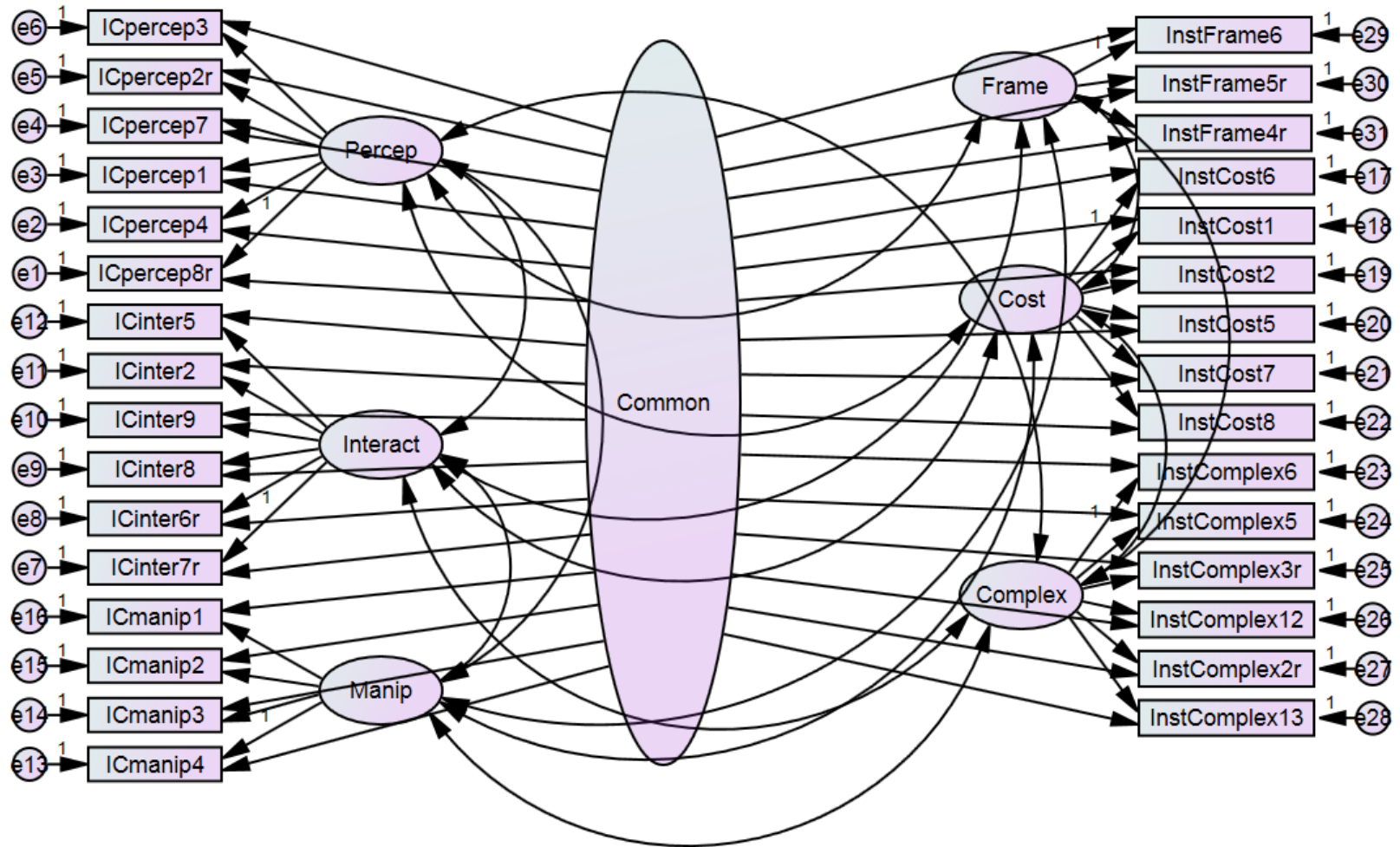


Figure 6: Common latent factor model to test for common method variance

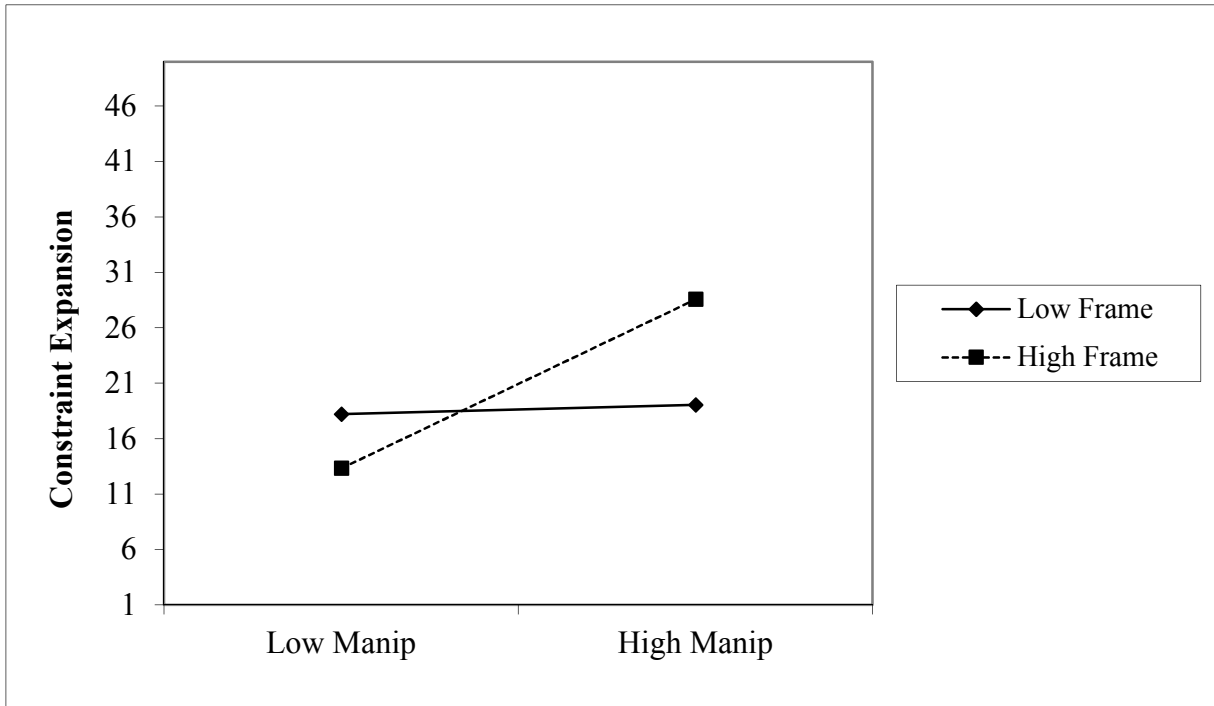


Figure 7: Interaction effect, manipulation capabilities by framing on boundary expansion

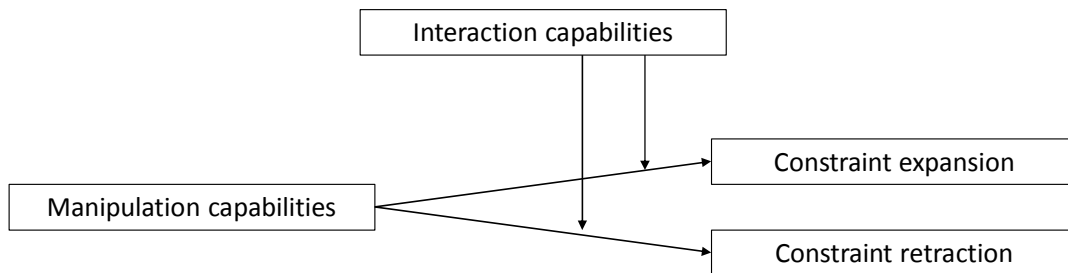


Figure 8: Post-hoc analysis: moderating effect of interaction capabilities

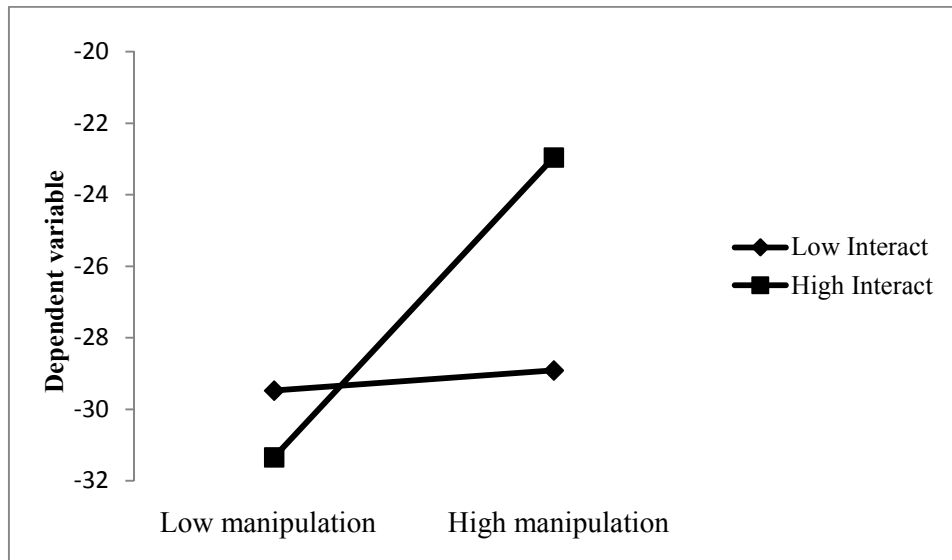


Figure 9: Interaction effect, manipulation capabilities by interaction capabilities on constraint retraction

APPENDIX 1 INTERVIEW QUESTIONS

General questions

1. How long have you personally been in the banking industry? How long have you led your current bank? What types of products and services do you offer? How has the bank changed under your leadership?
2. When was your bank founded? How many employees does your bank have? What sort of growth has your bank encountered in the past five years? What about going forward – where do you see your bank five years from now? How about the banking industry in general?

Basic regulatory questions

3. Does your bank have a state or national charter? What influenced your decision in pursuing this charter? What are the implications for your bank in either having a state or national charter?
4. What regulatory agencies oversee your bank's operations? How much interaction do they have with you and your bank? Are some agencies more interactive than others? Why do you think so?
5. Do you personally interact with the regulatory agencies or are there others in the bank who manage these relationships? Regarding the agencies themselves – do your interactions tend to be with specific people, who you have come to know, or are they more generalized across many people from the agencies?
6. How would you characterize your relationship with the various regulatory agencies? How do the agencies help your bank? In what ways do they hinder your bank?
7. What role do you think these regulatory agencies play in shaping the banking industry performance in general? What about your bank specifically? Is a significant portion of bank industry performance determined by regulatory agencies? If so, how do you think you can improve your bank's performance? If so (c

Drilling down

8. If regulatory agencies write the 'rule book,' which your bank has to follow, how do you know what's in the rule book? Is it a matter of reading the existing rules and statutes? Do you do this yourself, or do you rely on others' expertise? If so, who do you rely on (others in your firm? others outside your firm, such as attorneys? others in the regulatory agencies?)
9. Is it easy to understand what the expectations of regulatory agencies are? Is it easy to understand the written rules that govern your operations? If so, why is it easy? If not, how do you clarify the meaning of written rules or comprehend regulatory expectations? Are there

10. differences between the written content of a rule and the expectation of an agency or how an agency enforces a rule? If so, how do you resolve these differences?
11. Have you been able to improve your ability to understand and “stay on top” of the regulatory environment? How?
12. Would you characterize any of the regulations you face as vague or unclear? Have you ever exploited a vaguely written rule to pursue the bank’s interests? Describe a situation.
13. In your day-to-day operations, when you have to make decisions, how relevant is existing regulation to how you make these decisions? How frequently are your decision options limited by regulation? How impactful are these limits on your bank’s operations?
14. How do you know when regulatory changes occur? Do they occur frequently? Are you aware of when regulatory change is about to occur? Does the potential for changing regulation influence how you make decisions related to your bank’s operations?
15. Are rules enforced differently, either by different agencies or by different individuals within an agency? Are rules enforced differently across banks? Are you subject to more strict enforcement than other banks? Looser enforcement? In what areas of your operations? Why?
16. Other banks likely have interest in the content of regulatory rules and how they are enforced. Are you aware of what other banks’ interests are? How? Can they be different from your interests? How does this awareness influence how you interact with regulatory agencies? How does this awareness influence your decision making regarding your own bank’s operations?
17. How often do you interact with regulatory agencies in a given month? Year? What types of interactions do you have? Regular inspections? Phone calls or emails? Industry-related events? Social gatherings? Are these interactions two-way streets – how interested are agencies in your interests or do they merely enforce their own interests?
18. Are some types of interactions more “interactive” than others – that is, are there situations in which they are strictly interested in enforcing their expectations and situations in which you may have greater input? Are different agencies (or individuals within these agencies) more receptive in your interests than others? Describe a situation in which they were receptive to your interests. Describe one in which they weren’t. Are there situations in which you were able to get a regulatory agency to become more receptive to your interests?
19. Have you built relationships with certain agencies or people within these agencies? How have these relationships been productive? Do agencies tend to be open to building close relationships?
20. Have you been able to improve your ability to foster relationships with agencies or individuals within these agencies? How?
21. Do agencies seek your input in creating new rules or enforcing existing rules? Are you proactive in proposing new rules, eliminating existing rules, or recommending tightening or relaxing enforcement? Do agencies tend to be open to your suggestions?
22. Have you ever been successful in encouraging agencies to eliminate restrictive rules or to loosen enforcement? How? Describe a situation in which you were successful. How significant was this change for your business? Describe a situation in which you were not successful.

23. In what situations do you seek these types of changes? Are you reacting to a specific customer request? Do you seek these types of changes as part of a broader effort to attract more customers or to provide new products and services?
24. Do these changes tend to be momentary – such as asking for an exemption to meet a specific customer’s needs? Have any of the changes you sought resulted in a rule change or a permanent, lasting change in how an agency enforces its rules? Have there been situations in which the regulatory change you sought was adopted by an agency and applied across the industry?
25. In seeking these types of changes – either rule changes or relaxing enforcement – what role do other banks play? Are other banks generally open to your efforts, or even support them? Have there been situations in which they resisted these efforts? What risks or threats do you face in seeking these types of changes? From other banks? From industry associations? From the regulatory agencies? How do you handle or reduce these risks?
26. Have you ever sought to actually toughen regulatory rules or enforcement? How? Why? In what situations? Describe a situation in which you were successful. How significant was this change for your business? Describe a situation in which you were not successful. Have other banks sought tougher regulation or enforcement in a way that impacted your business, either incidentally or deliberately? Describe a situation like this and how you reacted.
27. Have you been able to improve your ability to affect the regulatory environment – either in changing written rules or influencing enforcement? How?
28. How important is the regulatory environment in your strategic decision-making? Does regulatory change – either seeking to relax or toughen the regulatory environment – play a significant role in your strategy? Do you tend to see the regulatory environment as highly relevant to your activities? Do you view the regulatory environment as generally positive or negative? Is the regulatory environment often discussed among you and others in your bank?
29. Do you often think about ways in which regulatory changes can benefit your bank? Do you see deliberate regulatory change as a tool to widen your products and services and improve growth? Do you see deliberate regulatory change as a tool with which to reduce competitive pressures?

**APPENDIX 2
SURVEY INSTRUMENTS**

Survey 1

(Part 1 of 2)

December 2013 / January 2014

National survey of U.S. bankers

Examining banking activities
within the regulatory environment



Conducted by:

Christopher Pryor

Doctoral Candidate
School of Entrepreneurship
Oklahoma State University

Instructions and general comments

Thank you, in advance, for choosing to participate in this important study. The purpose of this study is to understand the relationship between performance and the activities bankers use to understand and interact with their regulatory environment as well as influence their regulatory environment.

Instructions

There are two parts of this study: (1) This survey, and (2) a follow-up survey, which will be sent to you once I have received your response to this survey.

- 1) This survey should take approximately 15 minutes to complete.
- 2) Please use the enclosed envelope to return your completed survey.
- 3) Upon reception of your completed survey, a second survey will be sent to you. You should receive this second survey in approximately 30 days after you return the first survey.

General comments

The following should be considered prior to taking the survey:

- Your participation in the survey is voluntary, and you can choose not to answer any questions that make you feel uncomfortable. Returning your completed survey in the envelope provided indicates your willingness to participate in this research study.
- Your responses will be held **STRICTLY CONFIDENTIAL** and will not be recorded or shared in a way that will identify you or your bank.
- There are no 'right' answers, so please respond in an open and honest manner.

You may contact me with any questions you have about this study. If you have any questions, please contact me at cgpryor@okstate.edu or call me at (405) 762-0347.

Thank you!

Christopher Pryor
 Doctoral Candidate
 Oklahoma State University

Part 1: These items ask you about your bank and your role in the bank.

1. What is your role in the bank? _____
2. How long have you held this role, in years? _____
3. How many years of experience do you have in the banking industry? _____
4. How many lobbyists does your bank employ, write '0' if none? _____
5. How many attorneys does your bank employ, write '0' if none? _____

Part 2: These items ask about the activities people in your bank may use to understand the regulatory environment. Please think carefully about the extent to which you **DISAGREE** or **AGREE** with the following statements.

Please indicate the extent to which you agree or disagree with each of the following statements:

	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
	▼	▼	▼	▼	▼
1. People in my bank subscribe to and read trade association email alerts about new regulations.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. In my bank, only one person is responsible for being aware of new regulations.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. In my bank, each manager is responsible for being aware of regulatory changes that pertain to their department.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Continue on next page ...

Please indicate the extent to which you agree or disagree with each of the following statements:

	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
	▼	▼	▼	▼	▼
4. People in my bank regularly read the text of new banking laws and regulations.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. My bank regularly sends managers and employees to compliance workshops hosted by trade associations or regulatory agencies.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. People in my bank are good at quickly understanding the intent of new regulations.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Upper management in my bank is aware of and takes interest in regulatory changes.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. To operate effectively, people in my bank need to have detailed understanding of every regulation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Understanding the "Cliff Notes" (e.g., summaries prepared by trade associations) of a regulation is good enough.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. People in my bank are good at quickly understanding which parts of a regulation apply to our bank and which parts do not.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Part 3: These items ask about the activities people in your bank may use to interact with the regulatory environment. Please think carefully about the extent to which you DISAGREE or AGREE with the following statements.

Please indicate the extent to which you agree or disagree with each of the following statements:

	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
	▼	▼	▼	▼	▼
1. I or others in my bank have a close relationship with the state banking commissioner.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. People in my bank feel comfortable calling state or federal regulators to ask questions about compliance.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. People in our bank are proactive and contact regulators before a problem arises.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. I or others in my bank participate on the advisory boards of regulatory agencies.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. We are familiar with the agents who examine us.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. There is not likely to be a familiar face on the next exam team.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Our bank takes an 'out of sight, out of mind' approach with regulators.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. We treat regulators like we would treat our customers.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. It is OK to call or email a regulator about a problem the bank encounters.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Continue on next page ...

Part 4: These items ask about the activities people in your bank may use to comply with the regulatory environment. Please think carefully about the extent to which you DISAGREE or AGREE with the following statements.

Please indicate the extent to which you agree or disagree with each of the following statements:

	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
	▼	▼	▼	▼	▼
1. Good compliance is our highest objective as a bank.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Our bank has a good reputation among compliance examiners.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Our bank regularly writes policies and procedures in-house rather than drawing on outside sources/templates.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Our board takes an active interest in compliance issues.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Our bank does a good job breaking procedures down into discrete, easy-to-follow steps. This may involve developing checklists, flow-charts, and tables for use by front-line employees.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Our bank regularly trains front-line employees regarding regulatory requirements.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. In our bank, everyone shares compliance responsibilities.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. In our bank, the president serves as compliance officer.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Our loan officers understand that compliance comes first.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

11. How many employees are in your compliance department or are otherwise dedicated to compliance responsibilities? _____

12. How much does your bank spend annually on compliance training? _____

Part 5: These items ask about the activities people in your bank may use to influence the regulatory environment. Please think carefully about the extent to which you DISAGREE or AGREE with the following statements.

Please indicate the extent to which you agree or disagree with each of the following statements:

	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
	▼	▼	▼	▼	▼
1. People in my bank visit representatives at the state capitol about banking issues.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. People in my bank write comment letters on proposed regulation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. People in my bank are involved with the governance committee of a state or national banking association.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. People in my bank speak with regulators about relaxing enforcement of a regulation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. It is possible to negotiate with examiners on compliance issues.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. We have found that regulatory boundaries are flexible.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. On occasion, it is better to act first and seek regulatory approval later.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. We don't always seek regulatory approval before making business-related decisions.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Continue on next page ...

Part 6: These items ask about your bank's general orientation toward regulation. Please think carefully about the extent to which you DISAGREE or AGREE with the following statements.

Please indicate the extent to which you agree or disagree with each of the following statements:

	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
	▼	▼	▼	▼	▼
1. Regulation ensures that every bank plays by the same rules.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Regulation is good for the banking industry.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Banks are overregulated.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Regulators are receptive to bankers' concerns.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Regulators are just trying to do their jobs, same as we are.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Regulators don't trust bankers.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Part 7: These items ask about the costs your bank bears due to the regulatory environment. Please think carefully about the extent to which you DISAGREE or AGREE with the following statements.

Please indicate the extent to which you agree or disagree with each of the following statements:

	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
	▼	▼	▼	▼	▼
1. Regulation prevents us from offering certain products and services to our customers.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Our costs due to regulation are a serious threat to our performance.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Please indicate the extent to which you agree or disagree with each of the following statements:

	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
	▼	▼	▼	▼	▼
3. Our training and compliance costs due to regulation have increased dramatically in the past ten years.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. The time I and others spend on regulation takes away from our ability to increase shareholder return.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Our bank's growth is limited mostly by the regulatory environment.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Regulation prevents us from meeting customer needs.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. My bank is overly conservative strategically due to regulation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. My bank has discontinued products and services due to regulation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Part 8: These items ask about the complexity of the regulatory environment. Please think carefully about the extent to which you DISAGREE or AGREE with the following statements.

Please indicate the extent to which you agree or disagree with each of the following statements:

	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
	▼	▼	▼	▼	▼
1. Banking regulation is easy to understand.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. The various banking regulations do not contradict each other.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Banking regulations are written by people familiar with how banking works.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Continue on next page ...

Please indicate the extent to which you agree or disagree with each of the following statements:

	Strongly disagree	Disagree	Neither agree nor disagree	Agree	Strongly agree
	▼	▼	▼	▼	▼
4. Regulators are consistent in their interpretation and application of regulations.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. New regulations are proposed very frequently.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. The pace at which new regulation is being proposed is accelerating.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Regulation takes into account the real world.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. There are often differences in how we interpret a regulation and how a regulator interprets the regulation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. The language in which regulations are written is easy to understand.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. Regulatory enforcement is very subjective.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
11. It is easy to know how to conform to a regulation.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
12. Two people can read the same regulation and arrive at different conclusions.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
13. It's impossible to read every regulation that is adopted.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
14. It is pointless to try to read a regulation — the clarification from our trade associations and other groups tell me what a regulation really means.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Thank you!

This concludes the initial part of the survey. Please return this survey using the enclosed envelop. After we have received the responses from the first round of the survey, I will send you the second round. This should take place approximately 30 days from now.

Thank you, again. In the mean time. If you have any questions or comments about the survey, please feel free to contact me, Chris Pryor, at cgpryor@okstate.edu or call (405) 762-0347.

(Part 2 of 2)

February 2014

National survey of U.S. bankers

Examining banking activities
within the regulatory environment



Conducted by:

Christopher Pryor

Doctoral Candidate
School of Entrepreneurship
Oklahoma State University

Instructions and general comments

Thank you, in advance, for choosing to participate in this important study. The purpose of this study is to understand the relationship between performance and the activities bankers use to understand and interact with their regulatory environment as well as influence their regulatory environment.

Instructions

This is the second and final survey of this study.

- 1) This survey should take approximately 5-10 minutes to complete.
- 2) Please use the enclosed envelope to return your completed survey.

General comments

The following should be considered prior to taking the survey:

- Your participation in the survey is voluntary, and you can choose not to answer any questions that make you feel uncomfortable. Returning your completed survey in the envelope provided indicates your willingness to participate in this research study.
- Your responses will be held **STRICTLY CONFIDENTIAL** and will not be recorded or shared in a way that will identify you or your bank.
- There are no 'right' answers, so please respond in an open and honest manner.

You may contact me with any questions you have about this study. If you have any questions, please contact me at cgpryor@okstate.edu or call me at (405) 762-0347.

Thank you!

Christopher Pryor
Doctoral Candidate
Oklahoma State University

Part 1: These are general items that will help ensure that the same person answers both parts of this survey.

- 1. Were you the individual who responded to the first survey? (Circle one) Yes / No
- 2. What is your role in the bank? _____

Part 2: The items below ask about the growth or decline in products and services your bank offers, as well as bank locations available for customer use. Please provide your best estimate for the following questions. These questions also seek to capture the difference in the regulatory environment's effects on banks between the time Dodd-Frank became law and now.

Please provide a number below



- 1. How many new products or services has your bank **introduced** in the past year?> _____
- 2. How many new products or services has your bank **introduced** in the past five years?> _____
- 3. How many products or services has your bank **discontinued** in the past year?> _____
- 4. How many products or services has your bank **discontinued** in the past five years?> _____
- 5. How many new branches/banking locations have you opened in the past year?> _____
- 6. How many new branches/banking locations have you **opened** in the past five years?> _____
- 7. How many branches/banking locations have you **closed** in the past year?> _____
- 8. How many branches/banking locations have you **closed** in the past five years?> _____

Continue on next page ...

Part 3: The items below pertain to the relationship between your efforts to manage the regulatory environment and regulatory change. Please provide your best estimate for each item. Again, these items seek to capture the difference between the regulatory environment when Dodd-Frank became law and now.

How many times, **in the past examination cycle**, have you been able to:

Please provide a number below

- 1. Negotiate with examiners to improve a loan rating?
- 2. Halt the implementation of legislation harmful to your industry through lobbying efforts?
- 3. Influence proposed regulation by writing comment letters?
- 4. Contribute to legislative efforts to loosen legal constraints, such as in working with a state or federal legislator?
- 5. Contribute to efforts of a state or national trade association to defeat bad legislation?
- 6. Obtain regulatory approval to open a new branch or banking location?
- 7. Discuss issues with a state or federal regulatory official, which caused him or her to change their attitude toward your bank?

How many times, **in the PAST 5 YEARS**, have you been able to:

Please provide a number below

- 1. Negotiate with examiners to improve a loan rating?
- 2. Halt the implementation of legislation harmful to your industry through lobbying efforts?
- 3. Influence proposed regulation by writing comment letters?
- 4. Contribute to legislative efforts to loosen legal constraints, such as in working with a state or federal legislator?
- 5. Contribute to efforts of a state or national trade association to defeat bad legislation?
- 6. Obtain regulatory approval to open a new branch or banking location?
- 7. Discuss issues with a state or federal regulatory official, which caused him or her to change their attitude toward your bank?

Continue on next page ...

Part 4: The items below pertain to the relationship between your efforts to manage the regulatory environment and regulatory change. Please provide your best estimate for each item. Again, these items seek to capture the difference between the regulatory environment when Dodd-Frank became law and now.

How many times, **in the past examination cycle**, have you attempted to do each of the following, but failed?:

Please provide a number below

- 1. Negotiate with examiners to improve a loan rating?> _____
- 2. Halt the implementation of legislation harmful to your industry through lobbying efforts?> _____
- 3. Influence proposed regulation by writing comment letters?> _____
- 4. Contribute to legislative efforts to loosen legal constraints, such as in working with a state or federal legislator?> _____
- 5. Contribute to efforts of a state or national trade association to defeat bad legislation?> _____
- 6. Obtain regulatory approval to open a new branch or banking location?> _____
- 7. Discuss issues with a state or federal regulatory official, which caused him or her to change their attitude toward your bank?> _____

How many times, **in the PAST 5 YEARS**, have you attempted to do each of the following, but failed?:

Please provide a number below

- 1. Negotiate with examiners to improve a loan rating?> _____
- 2. Halt the implementation of legislation harmful to your industry through lobbying efforts?> _____
- 3. Influence proposed regulation by writing comment letters?> _____
- 4. Contribute to legislative efforts to loosen legal constraints, such as in working with a state or federal legislator?> _____
- 5. Contribute to efforts of a state or national trade association to defeat bad legislation?> _____
- 6. Obtain regulatory approval to open a new branch or banking location?> _____
- 7. Discuss issues with a state or federal regulatory official, which caused him or her to change their attitude toward your bank?> _____

Continue on next page ...

Part 5: The items below pertain to the relationship between your efforts to manage the regulatory environment and regulatory change. Please provide your best estimate for each item. Again, these items seek to capture the difference between the regulatory environment when Dodd-Frank became law and now.

How many times, in the past examination cycle, have you been able to:

Please provide a number below

▼

1. Attract regulatory attention to the non-compliant activities of your competitors?> _____
2. Work with state or federal legislators to write law restricting the activities of credit unions, farm bureaus and other non-traditional banks?> _____
3. Halt the implementation of a new law that would have unduly favored your competitors?> _____
4. Discuss with lawmakers your concerns regarding "shadow banking," which caused them to change their attitudes toward that industry?> _____
5. Discuss with lawmakers your concerns regarding credit unions/farm bureaus, which caused them to develop negative attitudes toward that industry?> _____
6. Influence regulation, such as through writing comment letters, discussing issues with regulators/lawmakers, or any other approach, so that your competitors' costs increased?> _____

How many times, in the PAST 5 YEARS, have you been able to:

Please provide a number below

▼

1. Attract regulatory attention to the non-compliant activities of your competitors?> _____
2. Work with state or federal legislators to write law restricting the activities of credit unions, farm bureaus and other non-traditional banks?> _____
3. Halt the implementation of a new law that would have unduly favored your competitors?> _____
4. Discuss with lawmakers your concerns regarding "shadow banking," which caused them to change their attitudes toward that industry?> _____
5. Discuss with lawmakers your concerns regarding credit unions/farm bureaus, which caused them to develop negative attitudes toward that industry?> _____
6. Influence regulation, such as through writing comment letters, discussing issues with regulators/lawmakers, or any other approach, so that your competitors' costs increased?> _____

Continue on next page ...

Part 6: The items below pertain to the relationship between your efforts to manage the regulatory environment and regulatory change. Please provide your best estimate for each item. Again, these items seek to capture the difference between the regulatory environment when Dodd-Frank became law and now.

How many times, **in the past examination cycle**, have you attempted to do each of the following activities, but failed?

Please provide a number below

- 1. Attract regulatory attention to the non-compliant activities of your competitors?> _____
- 2. Work with state or federal legislators to write law restricting the activities of credit unions, farm bureaus and other non-traditional banks?> _____
- 3. Halt the implementation of a new law that would have unduly favored your competitors?> _____
- 4. Discuss with lawmakers your concerns regarding "shadow banking," which caused them to change their attitudes toward that industry?> _____
- 5. Discuss with lawmakers your concerns regarding credit unions/farm bureaus, which caused them to develop negative attitudes toward that industry?> _____
- 6. Influence regulation, such as through writing comment letters, discussing issues with regulators/lawmakers, or any other approach, so that your competitors' costs increased?> _____

How many times, **in the PAST 5 YEARS**, have you attempted to do each of the following activities, but failed?

Please provide a number below

- 1. Attract regulatory attention to the non-compliant activities of your competitors?> _____
- 2. Work with state or federal legislators to write law restricting the activities of credit unions, farm bureaus and other non-traditional banks?> _____
- 3. Halt the implementation of a new law that would have unduly favored your competitors?> _____
- 4. Discuss with lawmakers your concerns regarding "shadow banking," which caused them to change their attitudes toward that industry?> _____
- 5. Discuss with lawmakers your concerns regarding credit unions/farm bureaus, which caused them to develop negative attitudes toward that industry?> _____
- 6. Influence regulation, such as through writing comment letters, discussing issues with regulators/lawmakers, or any other approach, so that your competitors' costs increased?> _____

Thank you!

This concludes the survey. Please return this survey using the enclosed envelope. I intend to have results, which I will forward to you, completed by the end of spring. In the mean time. If you have any questions or comments about the survey, please feel free to contact me, Chris Pryor, at cgpryor@okstate.edu or call (405) 762-0347.

APPENDIX 3 INTERVIEW TRANSCRIPTS

Interview No. 1

Does your bank have a national or state charter?

State charter. This is my 40th year in banking. The first 20 were with a national charter bank. Stillwater National Bank. During that time, one year, I was a special assistant to the comptroller of the currency, the principle regulator of national banks. When we started our last bank, Oklahoma National Bank, I was very focused on a national charter. And in course of managing Oklahoma National Bank, I had a long term positive relationship with the state banking commissioner, Mick Thompson, and so I would talk with our regulators with the SEC about issues and I would talk to Mick about issues, just as a friend, and he seemed more flexible with letting us do what we wanted to do. In our case, the principle issue was our rate of growth. And so from Mick's point of view, as long as it was quality growth, he was OK with that. We changed our charter at Oklahoma National Bank to a state bank, called ONB Bank, which we had been saying in our advertising anyways, so the public didn't care. In my research of that, I realized that there has been a dramatic shift in the last two decades of charters from national banks to state banks across the country. I'm not sure what everybody else's reasons are, but I think it has to do with what business opportunities are you trying to pursue and who's going to be more flexible and who's going to be less flexible. All of them are going to make you comply with regulations and so forth, but there's a lot of subjective regulatory oversight. It comes down to, Mick Thompson's a guy I can contact, and he'll pick up my call, and I've got an issue, we can talk it through. He's not going to let me do anything I shouldn't do, but he listens. He responds. The FDIC is our national regulatory, and in our case, we have a bank holding company, so we also have the Federal Reserve as a regulator, which we would have as a state or national charter.

I have done both, as a new charter, and it has seemed to me that relationally, while I think they were both good, I think working with Mick has been better. And the FDIC has been cooperative, down in Dallas, with what we're trying to do. I think relationships really matter, and I have always had a good relationship with the comptroller of the currency, especially as I was in Washington as one of their senior officers. But I think because Mick Thompson is in Oklahoma and he understands what we're talking about – such as growth – Jenks is only across the river – it's not really a different market. It's good to have a regulator who knows exactly what you're talking about and can respond to you.

Paint a picture of your overall regulatory environment. Who do you have to answer to?

Everyone. Because we have a state charter, we have a primary federal regulator and the state banking commission – so the FDIC and the state banking department are both primary regulators

for us. If we were, as a bank, a member of the Federal Reserve, it would be the state banking commissioner and the Federal Reserve, rather than the FDIC. We did think about that because we do have a holding company, and so we also have to respond to the Federal Reserve.

How much interaction do you have? Agency by agency ... what's the interaction like with each one of those?

As a startup bank, it's different than as a mature, ongoing bank. As a startup bank, you agree to not only the standard conditions banking operation, but typically they have special conditions that until you reach a certain level of maturity, you have more dialogue. You have to get more permission to do stuff. So it depends on how new you are and how active you are. For example, in our case, when we got a charter approved, they agreed to let us build an office at 41st and Rockford, which is off 41st and Peoria, that we were going to move into and see how it went. Subsequently, we decided this was a nice building and nice people, but we couldn't have a drive-thru, we couldn't have signage. Parking, as you've experienced, is not perfect. And so, we wanted to build a headquarters at another location, but we had to get their permission to do that. If we were a mature bank, we would have to have their permission to move headquarters, but the cost wouldn't be a big deal. But since we're a new bank, it is a big deal. When we first talked about it, at that point, we still weren't making any money, and they told us to wait until we were making money. So there was an ongoing dialogue about our desire to do that. The amount of communication for a newer bank is greater than for a mature bank, and the amount for a bank that wants to do stuff and for a bank that wants to stay where they are is more. One who wants to do new stuff – like build a headquarters – anytime you want to do something different, you've got to get approval. Because of that, we have more regular communication than we might otherwise, because we don't want to surprise them. We want them to know our plans, we want them to know where we're going. We give them regular updates on how we're doing, even though they're not asking. Because when we get around to asking, we want them to know how our thoughts developed and how that fits into a logical continuum of what we're doing. We send in quarterly reports just like everybody else does, and then we probably talk to them quarterly – we don't have to – but from a relational point of view, we let them know where our plans are going. And certainly, when we want to do something new, we'll tell them what we're wanting to do, get their advice, and then make a proposal.

Is this for the three different agencies? Or are you talking mostly about the state?

The state and the FDIC. We have to get permission as a bank. The Federal Reserve really relies on the state and FDIC to oversee the bank. But we do have to get their permission if we want to borrow money as a startup bank, and if we want to do anything as a holding company to effect the bank, we have to talk to the Federal Reserve, so we send them a copy of our annual plan and our long term plan just so they'll know what we're doing. Probably, in that case, we meet with them once a year.

Are some agencies more interactive with you than others?

They are active in a lot of different ways. One, for example, the FDIC has an initiative under the Community Reinvestment Act, what they're calling economic inclusion, which has just started in

Tulsa. They came to visit us about our possible involvement, and so we started it. It's something we'd like to do anyway, they're sponsoring it, so it's a real plus from our point of view. I'm on their advisory board, and I talk to them once a month about promoting economic inclusion. Then, if we have a question that comes up that we haven't faced before or it's out of the norm for us, we'll touch base with either our examiner or somebody. Each of them have an examiner in charge, who we communicate with, and in my case, I communicate more with Commissioner Thompson, just because we're old friends.

Are you the one personally interacting with the agencies, or are there others ...

I'm the chairman and co-CEO, and my son Tom is president. We both interact with all three of the agencies. In our division of duties, it's more my responsibility to interact with the senior people at the agencies, and then, others who work at the bank – in their area of responsibility – compliance, interact with compliance officers at the FDIC and state. They examine our compliance, our CRA, IT, as well as the normal CAMELs ratings issues. Our chief credit officer is a former national bank examiner himself and has had relationships with regulators – may call into question, “Here's what we're doing on appraisals, what are insights that you can help us with?” Sometimes, it's technical issues, and sometimes it's broader issues.

It's very relational.

You don't see – there's not a state banking commission. It's the people within it. It's not a faceless bureaucracy. Is that true across the agencies, or is it more true with the state because you know the commissioner?

I would say – that's a really good question – as comparing the state banking department with the comptroller of the currency, it's much more relational because the comptroller's in Washington, and when I lived in Washington, he left shortly after I left, so I didn't have a relationship there I had before. I think non-major banking companies, you aren't likely to have a personal relationship with the comptroller of the currency, and you're not likely to have a personal relationship with the chairman of the FDIC. But you are likely to have a relationship with – all banks in each region have a person in the regional office that is their principle contact – and we have a relationship with that person. And also, to the extent that we are doing anything – we went through the approval process to have a charter and so we established a dialogue with some people in the Dallas office that we continue to contact. And then you have an ongoing relationship with your examiners that hopefully, for all banks, is very positive.

At the other banks you've been ... is it the same way as it is here, where you're the one person who's interacting? At a place like Stillwater National Bank, is Rex Horning doing all the interacting with the commissioner, or those larger banks – do they have departments?

It probably depends on the bank. At the very largest bank – CitiBank, JPMorgan – their primary regulator has an office at their office. So they're there 12 months out of the year – they're there all the time. So that's really different. Those are mega institutions, and it's a constant oversight –

and they probably do have a relationship with the comptroller or the chairman of the FDIC or the chairman of the Fed because it's a big deal.

There are a lot of things that go on in Washington that don't have a lot to do with community banks but do have a lot to do with the banking system, that I got to learn when I was there, and it's very interesting, but it's not our problem. It really depends on the personality of the bank. When I was with Stillwater National Bank, the CEO was Bob McCormick. Bob was the principle person interacting with the regulators, and that was the OCC. However, during bank exams, I was in charge of lending, so I would be responsible for interacting with the examiner in charge on our loans. McCormick also sat in on that, but we would talk through all the loans and the quality and so forth. It probably depends on the bank. In our bank, there are probably more people who have contact with the regulators, which we think is a positive thing. Tom and I are probably the ones who coordinate that flow of information – we don't want them to be surprised, but we don't want to be surprised either.

What's the posture of the agencies you deal with toward your business? Do they facilitate? Do they goal keep? Hamper? How would you characterize their mission and orientation toward what you're trying to do?

It depends. It depends on what they're looking at and what their concerns are. I found them all to be generally cooperative. I believe their mood has changed from time to time as the economy has changed and as their issues have changed. I think the current environment has much more emphasis on compliance than it did before because it's the environment we're in. I think this environment – this economic environment – has been more concerned about rates of growth and things they perceived have caused failures at other banks. Now, there's a lot more research that has been done in the past twenty years on the causes of bank failures, anything that looks like that, you raise a red flag. I would say I have found them very cooperative when we're talking about a new idea – something we want to do in the future. And helping us think about how that fits within what works for them. I think they're also very clear if they have a concern about what you're thinking, and most of the time that has caused us to back up and go OK, is there another way of thinking about this. We want to grow. Ours is a rapid growth model. And we know that's out of the norm. This time, for example, we have raised more equity capital – substantially more equity capital – than we did ten years ago. Ten years ago, we were able to use more debt in the holding company, and this time they preferred that we raised equity capital, and so we did.

Were you proactive in that? Did you anticipate that?

I wasn't. I understood that the whole international regulatory environment is focused on more capital in the banking system – Basel III and so forth. The whole environment has been, they'd rather you have equity capital rather than debt. I listened to that and set that in the context of the discussions we've been having, and I went to our stockholders and went, "Look, they're going to make the whole banking system have more capital." Forty percent of banks never raise additional equity capital after they start. Forty two percent only raise additional equity capital once after they start. So only 18 percent are actively raising capital. That means there are going to be a lot of banks that either don't grow or they shrink to fit their current capital level, so I

think that's an opportunity for banks to go out and aggressively raise capital. So our stockholders went, "Yeah, I think you're right, and so let's put up more capital."

They didn't say, you have to go out and raise more capital. You know, X million more dollars in capital. But they said, we're concerned about these capital ratios as you grow. In ONB, the way we solved that problem is we went out and borrowed money in the holding company and put that in the bank as capital. And we listened to them, and they said that's not what we want banks to do right now. So we went, OK, as long as everybody is playing by the same rules, good.

What role do you think regulatory agencies play in shaping industry performance, in general?

Very significant. And more significant in economically difficult times than in happy times. They have less concerns in happy times, and they have great concerns in difficult times. For example, in our last bank we were a very active lender of development and construction lending because the economy was working and the pro formas were working, and so we were very active in that. We don't have development loans in this bank because that's an area where a number of banks got in trouble with those kinds of loans. That's an area of regulatory concern, and we don't want to hit that hot button. We're focused on things of less concern. So they can very much shape what somebody does by what they're concerned about and what they're less concerned about. We were less focused in the beginning on profitability and more focused on getting to scale. They were really focused on getting profitable more quickly, so that changed our focus. We slowed down our growth to get profitable sooner, so that impacted us. By and large, I would say their impact has been positive, they give good advice, and they have tried to keep all banks within parameters that would keep them from getting into trouble. And to the extent that there's a more entrepreneurial bank trying to do something outside the norm, that's going to be hard to do, so you know you're going to face a lot more scrutiny doing that. People think more deliberately about their plans if they know they're going to have to answer for them.

The agencies write the rule book. How do you know what's in the rule book?

Our chief credit officer is a former bank examiner and has a great deal of knowledge. Our chief financial officer stays up with all the financial rules. Our chief operations officer stays up with all the compliance rules. It's a shared task, and we talk about it all the time. It's constantly on the horizon.

How do you do it? It's 8,000 pages of Bible-thin paper and little bitty type. It's so overwhelming, it seems. Do you set aside time each day to read ...

Yes. You read. You go to conferences. You attend seminars. And you hire consultants. We, particularly in compliance and IT, we have had external audits by people who are experts in those areas to make sure we are compliant. If there's something we missed in our reading. We attend seminars to listen to what are the hot issues of the day in exams. Banks don't share much information about ... banks are not good cooperating on credit. But they are good at cooperating on how we work with our regulators. This is what's going on in the exams we're experience, so how do we all listen to what they're trying to say and apply that to what we do?

We spend enormously more time thinking about regulations today than we did a decade ago. And enormously more than we did twenty or thirty years go.

When I was in Mr. Gilbert's office, he showed me two books. One was the book of every rule that had been written between 1970 to 1990. And then he showed me the binder – one of five – which is a fraction ... most of the rules haven't been written yet.

Is it easy to understand what the words mean?

Most of the time. We have a general counsel who we use, whose clients are primarily banks. We have a specialist in regulatory issues who is an attorney in Oklahoma City. If you have a question of a technical nature. We use consultants and attorneys to help us make sure we understand what those are about.

Is there a difference between the written rule and how it's enforced?

I don't think they mean to, but because they are human beings, different examiners may see it differently. And different examiners in the field may see it differently than their headquarters. The truth is, there may be functional differences because banks do it differently. We are not a heavy consumer lending bank, so what we may be doing as compared to a bank that is principally consumer lending, would be very different. We're probably easier to examine than someone where that's their primary business. We own a mortgage company as part of our bank, and so we know there's a whole new set of rules in the mortgage industry, and some banks don't make mortgage loans. Ours would be more complicated than other people.

Whenever you encounter ambiguity – maybe the last time you encountered ambiguity – or uncertainty regarding what a rule was ... is that a phone call to the attorney? To the commissioner?

Well, it's probably first a phone call to the attorney or a consultant on that topic. To say, hey, we were thinking about this, what have you heard? And then we formulate something and if we think that's right, we go forward, and if we aren't sure, we'll probably call our examiner in charge first and say, what do you think? If they're not sure, then we go up the organization. For most banks, your principle relationship is going to be with the examiner in charge.

Let's say you had at Time 1, X, an ability to understand new regulations and now you're at T = 3, how has your X improved? How have you improved your ability to understand the regulatory environment?

I think understanding the context is important. How things evolved. What are they trying to achieve? What's the point? Usually there's a logic and there's a fairness in the discussion, particularly if there's a misunderstanding about something. What's material, and what isn't material. I would say our industry right this minute, in the last three years, three years ago, you would have said there was a lot of confusion about what the rules were. Less confusion two years ago. A little less a year ago. It's clearer now, because we're coming out of the fog of the

recession. When chaos appears in the economy, there's just a lot of confusion. They aren't sure what to do. A lot of banks chose to shrink. They chose to turn inward and focus on problems that needed to be fixed, which created enormous opportunity for us because they were focused on themselves and we were focused on customers. We see them coming back in the game now. They've got their problems solved or manageable, and we see them coming back.

There's been a lot of consolidation too. I can't imagine how hard it would be to be sitting in Locust Grove and deal with this issue.

I don't know how small banks do it. We have a number of people focused on compliance issues. I can't imagine how a bank with only 20 people can do that. The consolidation is not simply driven by increased regulation, but increased regulation has contributed to consolidation. There are 57 percent fewer banks today than 25 years ago, and its getting less. Which, from a banker's point of view, that's a good thing. From the economy point of view, I think it's not a good thing.

But you're one of the only startups ... how many years do you have to go back?

Technically they're treating us as a charter. We bought a charter of a bank in Glenco. If you drive from Stillwater to Tulsa and back, you touch Glenco twice. In 1999, we applied and received a charter for a national bank, Oklahoma National Bank. We talked to them when we were going to start this bank, and they said, yeah, sure that's fine. And as the discussion went along, they said we'd rather you buy a bank. I think in 2009, I think they approved five charters, and they were all working on it in 2008, and I think they just quit approving them. I think in 2010, they didn't approve any charters. They don't approve charters during a recession. It tends to ebb and flow with the economy.

When you're doing your day-to-day operations, how often do you run up against a regulatory boundary? Is that relevant to your decision making?

There's regulatory consideration in almost everything we do.

Are there examples you can give? Maybe how it's limited the options you have? Or the effectiveness of what you've decided?

Every time you do something or create a new product, you go, well, how do we make sure that's compliant, we want to make sure we're staying within the regulations. So you just have to say, we'll do it right. We're updating our Web site, as a current project, and so the first issue is, well, is there anything involved in that that we have to improve the compliance? And then, as we think of these 10 more things we want to add, what issues does that raise? So we need to be sure that we're compliant. If I think back on my 40 years, in the first place, we didn't have Web sites. And in the second place, there weren't regulations we have to worry about. That's pretty different. When you think about – we are presently thinking about going to Oklahoma City. Well, we know we have to get permission to do that. Now, we've been laid out in our strategic plan, that that was our long term plan to go to Oklahoma City, well now we have to develop a proforma of how that's going to work. How is that going to affect our growth? Our profitability? Do we have enough capital to do that? That's both a technical issue and a strategic issue; when you're doing

those things, you have to think about how that will fit into the regulatory environment at this time?

Think about the type of loans you make – it's going to be a while before any new development loans are approved in the country. Nobody's getting any loans. That's really different. Now, as there's a shortage of lots, they're going to be some activity, but they're not going to be as easy as they were five years ago when everything was booming. Spec construction loans have been more difficult to get because that's a bucket you know – those things, when they do a bank exam, you know that's going to be the first thing they look at, you're going to be cautious about filling that bucket.

How much input is there, when, with the agencies you deal with, they propose a new rule or new enforcement standards. How much say do you have in the outcome?

In things like capital regulations and Basel III, they have hearings and they have public comment periods. In that particular instance, my son Tom's on the board of the Oklahoma Banker's Association, we wrote our opinion to both the OBA and to the regulatory agencies. We thought that was overkill for community banks. There's a lot of opportunity for input on major changes. Some of the things are more technical in nature, and it's more of a dialogue or an interpretation.

Are there written rules for everything, and then there's enforcement on top of that, that's malleable?

There are more and more written rules for more and more things. In the past, when I was doing exams in the late 70s and 80s, you'd have a discussion about something, they'd take your word for it and then you'd come back to examine it to see if it worked out like you said. Bank credit files, particularly community bank files, didn't exist till the 70s. They evolved through the 80s. Bank lending policies didn't exist until the 70s and they evolved in the 80s. It's gotten to the point now, if it's not in writing, it didn't happen. Everything's in writing. Every policy is in writing, and every policy is going to be reviewed by examiners.

Do you try to have a say in the process? How do you try to get involved in it?

Through our trade associations primarily. The OBA, the independent banker's association. You know, they have full time people studying these issues. They ask for input. They're a good voice for us. Where any of us as individuals – we're trying to run a bank, and we don't have time to run up to Washington and chat.

But at the state level? You also rely on associations?

The OBA is a very effective voice for the banking community in Oklahoma. But we also value our relationships. I really believe that the people at both the FDIC in Dallas and in Oklahoma and the people at the state banking office want to do what's fair. Want to do what's reasonable. They understand that if they just pass something, that's what it says and it's going to take us a while to figure out what it's going to mean and how you apply that. And we're going to discover what were the unintended consequences of that. Again, it's more relational than you might imagine.

A rule that's not enforced isn't a rule ...

The problem is that there are so many rules. Determining which apply to your circumstance, and what does that mean with your lens and with your circumstance, can be variable. There are specific exclusions for smaller banks related to bigger banks. Part of that, I think, is based on not everything is understood in writing, a lot of things are understood in relationship. By analogy: if I am lending money to you, and I've just met you, I'm probably going to be more concerned ...

If I've been lending money to you for a decade, and I understand your business plan and how it's working, and we've had discussions for a decade about your management team and your philosophy, and I see how it's working, I'm going to have less concerns than if you're a brand new customer and I'm trying to learn your business and figure out how it works. And I think that's true with regulators and banks. That an advantage over my son Tom is that I've been around for 40 years, and they've seen what I've done, and I've been a survivor in different economies and have had successful banking operations. The flip of that is that I've never seen anybody in the banking business with Penn Square Bank on their resume. So if you're associated with a bank that goes down, that's not good.

Is the relational such an important component that it'd be hard for somebody who didn't have any background at all? There's nobody going to be writing a business plan for our business plan competition who's going to be starting a bank – or will be successful – unless they've got family history or someone involved that's related to a bank.

They would have to have knowledge of how does it work. I mean, they could write a business plan, but they're not going to have credibility with regulators that they know how to do it, if they haven't done it. If they can't see a track record. For example, in our circumstance, we have our chief credit officer – a former regulator, a former consultant to banks on how to work with regulators, and was with us at our last bank as our chief credit officer. And our chief lending officer has been with me since 1980 in Stillwater and at ONB. So there's a continuum of knowledge. And the younger folks, Tom and his generation, are establishing those relationships, and as we retire, they will have been working at it for 20 years and have relationships with people. When I tell you I'm going to do this, we've had this discussion 10 times before, and you know I did it.

I wonder why if that's why banks, as opposed to other businesses, tend to be family businesses.

Community banks, it's very common. Ours is adnormal. The normality is that we have a number of family members working together. The adnormal part is that we have 211 others. Most community banks are run by relatively small numbers of people, and they tend to be family members or golfing buddies. Part of my research is looking at – the why – you can look at the number of employees over time, the number of senior managers over time, the number of investors over time, and say that there is a covariance with the growth of the organization and the number of people involved, which I'm describing as human and social capital. Banks that don't

have as many investors, employees, don't grow. There's a lot of reasons for that, but it's their business model, I think.

Most small businesses – community banks are really small businesses – most small businesses stay small and never intended to get big. We started off as the third smallest bank in Oklahoma when we bought Glenco. At Oklahoma National, we started off as the smallest bank the day we opened. Oklahoma National is one of the top twenty banks in the state. We're now 69th largest in Oklahoma with First Oklahoma. That's my intent. Most banks kind of hit their groove.

They're not trying to do what we're doing. And I would say, most banks, are easy for the regulators to regulate because it's pretty much the same thing year after year after year. Ours is different, we know it's different.

When was the last time you were able to move the boundary in pursuit of an opportunity?

By concrete example, there's always a boundary on where you operate – where you do business. We had to get permission to build a new building, and it was a dialogue of why did that make business sense, how did that investment relate to the amount of capital we had in the bank, and how did that relate to the profitability of the bank? In first having a dialogue, saying, here's what we want to do, and the regulators saying, here are the issues you have to address, and then we came back and addressed those issues, and then we got approval to do that. To get into a new line of business – or a new market – well, that's a boundary, so to do that, we have to explain why it makes sense, how it affects our profitability, and do we have the capital to do that?

But there's no rule change, no enforcement change taking place. Are there changes that take place that are industry wide? Say, you pursue an action that results in a policy change that influences all the other banks.

Well the biggest change I've seen in that regard, in my career, there used to be in the state of Oklahoma, each bank could only have one branch. It had to be within 1,000 feet of your headquarters. In the economic crisis of the 80s, the economy collapsed, there was a need to consolidate to keep banks open. Because of the problem banks, there was a need to change the law to allow strong banks buy weak banks and have multiple branches. That was a way in which things changed dramatically, and the number of banks in Oklahoma declined by 57 percent as the bigger banks bought the smaller banks, or as the smaller banks combined with stronger smaller banks. Philosophically, I think the idea of limited branching was winning until the economy collapsed, and then it went away. I was on that side, and we lost.

How did that rule change take place? Where did it start?

There were multiple sides. On one side, there were those who wanted to acquire more branches and limit competition under the theory that more banks provide broader services than a few, smaller banks. From a regulatory point of view, I think the state banking commissioner tended to be favorable to the community bankers concerns, the comptroller of the currency was very much for nationwide branching. So there was differences in opinion among the regulatory community. One of the things I learned when I worked at the comptroller of the currency, back in 85 and 86,

there is no monolith in regulation. Now, there is a singular voice that comes out of the agency, but there's a lot of different opinions within the agencies of "what are the right regulations, and what do those mean?" You don't know it on the outside because they're going to talk to you with one voice, but you're going to have people sympathetic to your cause on the inside who go, "Actually, you're right."

Is it possible to know ... you've got so many players, so many different interests in what the boundary is, different banks, different regulators, different voices ... how good are you at knowing what those different players are?

It's hard to know. Part of how you know that is from people who have been in the agency and left and become consultants on the outside. They know who's on which side of the debate inside the agency. And you can know that the agencies are debating between themselves because they're public about it. They clearly disagree on some things, and you naturally tend to gravitate toward those who you agree with.

Do you see those conflicts ... do you try to take advantage of them in certain ways?

I would say I avoid conflict with my regulators as much as possible. There's enough conflict in life, and I don't want any conflict there. We're going to be compliant. We want to understand the rules and abide by the rules. We will tell them if we disagree but we'll do what they say.

You will find that (conflict) among regulatory agencies. We know when they sometimes disagree with each other on what we're doing and what did that mean.

Do banks rat on each other?

I don't think they do it like that, but I think where it happens, during a bank exam, I mean you live with regulators for two or three weeks, and they're talking to you about what's going on in your bank and they're talking to you about your competitors and what's happening. So they're offering opinions, you know, "Those guys are crazy." I know we're an anomaly, and you look at our growth compared to the others and you go, "Oh, that's different." I know we have our critics, and that's just life. If you're doing something different in life, you will have critics.

The pushback you face from regulators ... do you get the impression that stems from other bankers' concerns or from other regulators' concerns?

I don't know, but I suspect it's some of both. We know we pay the top CD rates in town, so it'd be easy for somebody else to go, "See, they're just paying the top CD rates in town to grow fast," and we're going, "Yeah, that's true. And that's bad because why?" We explain our business strategy, and does that result in us having a more narrow interest margin? Yes it does. It's no hugely more narrow, but we think in the long run, because we'll have a greater pool of assets, we'll make more money. We're more focused on longterm shareholder value than this year's shareholder value. And that's our model, and other banks are focused on this year's earnings, and I understand that.

How has your underlying ability to create relationships changed? How have you gotten better at it?

I've learned not to surprise them with anything, and I've learned way in advance to say, "This is what I'm thinking about." I've learned to listen more than tell; to ask questions more than make assertions. And to say, this is what we see. How do you see it? Help us understand if that's bothersome to you, and how would that be different? I think that over the years, I've learned to stay in touch more often. Are you married? Well, one of the things you'll learn about marriage is communication is like oxygen: the less communication you have, the less oxygen you have to breathe, and you need oxygen to live. If communication goes away, you will die. The marriage will end. Similarly, in a relationship with a regulator, communication is really important, particularly if it's abnormal. I don't want them to find a problem. If I have a problem, I should know it, and I should call them and say, "I've got a problem." Something came up and I want you to know about it. Do you have any advice for me? That's a lot better than them showing up in a bank exam and them going, wait a minute, you've got a problem.

Before you knew these lessons, how did it hurt what you were trying to do as a banker? Do you have examples?

In my younger years as a banker, bank exams then were unannounced. They would just show up on a Monday morning, and the first thing they would do count all the cash. (They quit doing that because there's not enough cash to make a difference.) Everything was supposed to be a surprise, and they were a surprise audit. When I was at the comptroller of the currency's office when that changed nationwide; now, they tell us when we're going to have an exam 90 days in advance. They ask for a lot of outside information they can analyze in advance. When they show up, the go, here are the 10 issues we want to work on and here's what else we want to know. Knowing that, that those rules changed – that that part of the relationship changed – as long as they're going to have all this stuff off site anyway, you might as well provide them with anything else they didn't ask for that they're going to find when they get here.

It's become less police oriented and more like a team.

The chief national bank examiner – I wish he hadn't retired the same time I did because that would have been a great ongoing relationship – he saw the job of the examiner as more of a consultant than as a policeman. Now, there certainly was a time to be a policeman, when they're doing something improper. But for the most part, helping them understand the rules and helping them get compliant, rather than I'm here to beat you up.

Do you see these people outside the banking context?

Not really. At least it hasn't been for me. The commissioner and I have known each other since I was a state senator. We knew each other in a different way, and he was a banker, so he was on our side. I think, particularly, with the changes in the rules on ... in the old days, you could take a regulator to lunch. You can't do that any more. You can't do anything that could appear improper, so that's put a real damper on knowing them on a personal level. And that's regretful. The other thing is, we're not in Oklahoma City, so we wouldn't see people in Tulsa if they're in

Oklahoma City. And we're not in Dallas. When I was in Washington, I saw everybody all the time, so that was different.

How often are you inspected?

Now, you send in a quarterly call report. Quantitative, unbelievable data available. So there's that. There's a bank exam, usually at least annual. During economic times, it depends on what the quality of your bank was. Usually, it's annually, that they're here for two or three weeks going through everything. And then there's special exams for things like compliance, IT, and the community reinvestment act, which are different from the annual exams, and those are every two or three years.

Is that all at the state level, or do you have different folks coming in here?

When we have an exam, because we have the state and the FDIC, every other time, the other agency is in charge of it. There is an examiner in charge for us at the FDIC and at the state, and last time, the FDIC was in charge of the exam, next time the state will be in charge of the exam. The Federal Reserve reads those exams and examines us off site.

What are the other points of contact are you have with your regulators?

Conferences. You'll see them at the state banker's association. They hold their own conferences, where they'll talk about capital or whatever, and we always go. I will at least annually, try to make an appointment and go down and visit. We're updating our strategic plan and I'll go down and say, well, here's how it's gone, and here's what we're thinking about. I don't want to surprise them with anything. Either our plans haven't changed, or they have changed, because of this, so here's what we're doing.

The banks that don't do that. What are the differences?

It depends on if what they're doing is the same thing year after year after year. It probably doesn't matter. If they're trying to do something different, then it matters. I'm guessing that those banks that know they're trying to be different communicate more often. And some banks that were the same size they were ten years ago – they're not kicking up any dust or making any issues – then it depends on how relational are the managers of that bank. Do they care about having a relationship? If they're highly capitalized, profitable, and not causing any trouble ...

Do you seek out the relationships you have now as a tool to use later? Or do you do it because you're a relational guy?

I think both are true. I think it has to do with the personality of the people in charge, and it has to do with what you're trying to achieve and how important is that to what you're trying to achieve.

Will the association or someone in the industry – try to place people from the banks inside the regulators?

Not really. I was an anomaly inside the comptrollers office – because I had been a banker and because I was going back. That’s unusual. There are a lot of former regulators working as bankers or as consultants to banks, but it doesn’t go the other way very much. I say that, and Mr. Thompson’s a former banker.

How significant is it the other way around – I have to talk to 15-20 bankers – how many of those should I expect to be former regulators?

If you talk to the CEOs, a number of them will have been regulators because that’s a great training ground for young bankers or people who aspire to be bankers. My bet is that at the bigger banks, most of them will have someone who was a former regulator. Perhaps their credit officer.

There’s this issue called framing – how do you think about issues – by analogy ... what’s your bank’s frame?

There are some bankers who think of bankers as a pain in the neck. I think – we have a public charter that we – our banking system is unique in the world. There is no banking system – and never has been a banking system – like the United States banking system. And I think a part of that has been the relationship with the regulators. I think it’s good to have competition between our regulators. We can be a state charter or a national charter. As a state charter, you can have the Fed or the FDIC. I think those are positive from the banker’s point of view. From a public policy point of view, I think it is a very positive thing to have oversight of banks, who might be misbehaving, on the negative side. But on the positive side, to encourage them in positive, affirming ways. My frame is that the regulatory environment is a good thing.

The community reinvestment act would be a good example of that. I think banks should be required to reinvest deposits taken from the local community back into that local community. I think that’s good public policy. I know most of my colleagues do not – they think it’s a pain in the neck. I think banks should be required to make loans to low to moderate income families and businesses because I don’t think they would, independently, choose to do that. We do because I think it’s the right thing to do. When I was a White House fellow, one of my key takeaways from that was – I was there under Ronald Reagan – and I was one of 14. Five of us were Democrats, two were independents, and seven were Republicans. We debated everything in the world for a year together as we travelled the country and the world. One of my takeaways were that the Republicans – their frame – is that the government is the problem. The Democrats consistently said, no, the government is part of the solution to that problem. Now, they can also be part of the problem, but it is really part of the solution because in a democracy, ‘We the people’ are the government and we’re acting on our behalf. So I’m a Democrat, and I believe Obamacare is a good thing. I see the largest number of bankruptcies in the country come from healthcare. I think it’s horrible that 30 percent of people in Oklahoma are uninsured. Yes it cause an adjustment to the system, and it will take a decade to work it all out, but we needed to move in that direction. I think Social Security is a good thing, Medicare is a good thing, because we all are either old or we have parents who are old, and we need to be concerned about people who are old and disabled. So it’s the frame I have.

Is that frame shared throughout the bank?

There's a lot of difference of opinions. And when you have 211 owners, you have 422 opinions. I would say our group has a more positive frame for regulation even though we probably are engaged more with them than most banks because of what we're trying to do. I realize as a democrat and a banker and a southern Baptist, that I'm in a minority group that is small in this country and small in this state. I would say that people who fight with the regulators don't tend to say around this business a long time. They will win. The regulators will win. They are permanent, and they get to decide. I think that there are a lot of really frustrated bankers about that, and I would confess that there are times when I'm frustrated as well. But when I drop back and go, well, they're fairly applying these rules to everybody else and that's just the way it is, I'll go along with this. I think it's important to know in life what you can change and what you can't change – what hill you want to die on. I'm not going to fight all those battles because it's not meaningful to me.

Interview No. 2

I will tell you – and this is great timing on your part – because there was a ton of regulatory – there's been a lot of new regulations come out in the last three or four years. The absolute worst being called Dodd-Frank. That is a killer for our industry.

What caused – and this is my personal opinion – in 2008, when the recession hit all the big banks – and if you notice, we got painted by a broad brush – Lehman Brothers was a bank. Well, they're no more a bank than you are. They're an investment house. And then you have the big banks – Bank of America, Chase, CitiBank – that are huge. But they painted community banks with the same brush, which is what we are. Which is what most banks are. You got ten of your top big banks that are huge, and the other 7,000 odd whatever are community banks taking care of people where we live. We take care of them there. We know our customers. But we're the same regulatory requirements because of them needing TARP money and they needed to be bailed out because they didn't have enough capital – what it boiled down to – they had funny capital. They'd show capital on their books of 12 percent, but when you took all the fluff out, they were between 2 and 3 percent. Now, we've been sitting at – Tier 1 capital, which is true cash, the real stuff – is at 8 percent. And most of us hover above 8 percent in the 8 to 10 percent range. Some of them are 20 percent, which is crazy because your return on equity is killed. But family owned banks don't care about the return on equity because they don't have investors.

So we've had Dodd-Frank come out, which it was about a 3,000 page bill. But honestly, nobody ever read it. By Nancy Pelosi's own admission, you have to enact it to find out what's in it, which is maybe the dumbest thing I've ever heard in my life. Be you Republican or Democrat – I don't care – but when the leader of the party says we have to enact it to find out what's in there – they don't even take the time to read the stupid thing – makes no sense. And that only set up the rules – there's today over 10,000 pages. So in essence, if it stays true to form, we're going to have over 30,000 pages of regulation requirements from one bill, which is absolutely asinine. How can a community bank keep up with that kind of oversight? And that's just the one thing. That's just the big one. There's tons of others that have been enacted – they've got a whole new

agency – the Consumer Protection Agency – we didn't have enough agencies? We've got the OCC – the comptroller of the currency – the FDIC – the Federal Reserve Bank – the state bank examiners – bank commissioners. We had plenty of regulators. Now, this one happens to be one that isn't subject to appropriations, which is absolutely unconstitutional, in my opinion, and in attorneys' opinions. They don't have to get approval from the House – well, we haven't had a budget from the House in so many years anyway, which is also unconstitutional – Obama's had one budget under his administration, which is unconstitutional. The constitution calls for one every year.

So this was formed – in my opinion – unconstitutionally. It is not subject to appropriations, so it's just at the will of the secretary of the treasury to fund whatever he or she wants however much he or she wants, which, again, is unconstitutional. They are running havoc – kind of picking and choosing how they want to attack people. They are a rogue regulator with unlimited power. They can make up the rules as they go. So far, fortunately, for us, community banks, they've really aimed at the bigger banks. Dodd Frank was aimed at the bigger banks, what everybody thought, but it's been dwindled down to – you know how it rolls down hill? – well we're all subject to it. That wasn't the intent.

Right now, the big one out is called Basel III. As of just yesterday, they didn't exempt community banks from it, but they softened community banks from a portion of it. We as community bankers believe we should be exempted from it, and Basel III – the whole purpose of Basel III was started by the international banking community. Europe – all the countries are participating – so that they would have capital requirements to do international business. I've never done a piece of international business in my life. Nor have any of my friends and associates in this state or in any other state. But now, they have brushed us with Basel III – well, it is absolutely crazy. We proved by the best test – the recession – that our capital requirements were fine. Community banks did fine. The earnings dropped, but we didn't close up and go away. The big banks were the ones that went under – that had to be pumped up because they didn't have any capital. Community banks are fine under capital.

I'm just giving you the tip of the iceberg in terms of regulation.

Here's the big issue that honestly we are advocating for and are concerned about at the same time. We think there ought to be a bifurcated system within banking. Have one set of rules for these 2 trillion dollar banks – these international banks – and then have another set for community banks. We don't look anywhere the same. We're nothing to the same kind of business. Maybe consumers – all in all, our balance sheets don't look anything at all alike. So why would you have a one-size-fits-all rule? Now, that's not been very popular, I can tell you, in Washington – or with the ABA. I'll tell you why. The ABA gets the biggest amount of their fees from the big banks because they pay by what your size is. So they're fees, next to mine, mine are nothing. So they're in favor of whatever the big banks are in favor of. Now, don't get me wrong – the ABA does a lot of great things. But they would be opposed to that bifurcated system separate set of rules because the big banks wouldn't like that. You hear a lot about too big to fail – and the flipside of that is, 'are you too small to succeed'? To stay alive, actually. We've already had real cases here in Oklahoma where they've sold out – they're so small that the owner said we don't think we can keep up with the regulatory issue so before they fail us because we

haven't been keeping up – or go to jail – not because they don't want to but because they physical cannot – so screw it, I'll sell. These banks are the lifeblood of their communities. I will give you an example: David Cook – he is the epitome of the community bank – rural community bank. Dave Cook's a very humble guy. If something happened to David Cook and his bank, that town would go away. Because he provides – when the bands need uniforms, he provides it. He serves on the fire department. He's a medic on their ambulance service. He referees their high school football and basketball games. I mean, this guy – let me tell you what – if you take that bank away from that community, you think Bank of America's going to have to move into Laverne, Oklahoma? No. They'll have no banking services. You talk to him, when you're up there, about what he's done in residential lending. He's gotten out of it. He and so many other bankers in Oklahoma – they can't keep up with the regulatory requirements. They don't have the staff or the resources. Now that's taking a guy out of the market for people who are buying 50 to 60 thousand dollar houses and giving them no avenues. So the people who they're trying to protect – the consumer – the unintended consequence is that they're killing the consumer in the process. Because they're taking guys like David Cook out of the business or that line of business.

How do you handle the regulation. If there's a rulebook, how do you know what's in the rules?

I will tell you – I read – I can't tell you how much I read on regulatory. Between David Cook and myself – he's chairman and I'm vice chairman. Paul Cornell is first vice chair and he will follow me as chairman. Our past chairman is Brad Swicky. Our president and CEO of the OBA is Roger Beverage and I would say between the five of us – and we are emailing each other all the time as a group. "I saw this work." I get everything from Capital Hill – and so do they – it's called The Hill; Politico; The American Bankers – we just get flooded. Every day, I bet I get fifty emails and I peruse them to see what regulation's being put in place. We've got kind of a two-pronged approach: 1) an approach to deal with what's already in place and how to get it whittled down away from community banks or more of a realistic version of it and 2) try to stop those things that are going to absolutely cripple us that they're talking about bringing on.

I will tell you, here again, I will tell you – this is another personal opinion – but I'm not sure if its an unintended consequence or an intended consequence from the regulatory bodies: it's a lot easier to regulate 10 or 15 or 20 banks than it is 70 some hundred. It sure has every indication of that (consolidation), from this administration. The regulatory agencies kind of flow as the administrations do. They're not going to do out in left field out against the administration. So my point being is: is this an unintended consequence or are the kind of OK if we end up with 10 banks at some point. You look at other countries – we've got a lot more banks than anybody else. You know where the largest bank in the world is? Taipei. We're not number one in the world – we used to be. We've got number two and three. China's right up in there. But, you know, Brown Vitter is another one that's trying to break the big banks up. Actually, most of us – now, the industry is split on Brown Vitter – Brown Vitter wants to increase capital requirements on the biggest banks; by the sounds of it, most of us wouldn't be against that. But the problem is, when you look on into that, this legislation, is that it will require, in essence, to survive, the big banks will have to split up, kind of like the Baby Bells did. To make them a bunch of smaller banks. We don't want to lose our status as an international industry and banking industry. None of us want that for the big banks. There again, two sets of rules. It makes sense. Let them play in the

international world and be a power in the international world. We don't want that to go away from the United States. To make us subject to what they have to comply with is absolutely asinine on a rational basis in any way you look at it. I will tell you, our legislators absolutely agree with that – from Oklahoma. We have great representation. The problem is, they are only so many. I will tell you, there are fine community bankers that agree with it (Brown Vitter), too. And the reason is they're focused on is because they think it will get them out of Basel III and some of that stuff. That's more important to them; hell, they don't care what happens to a big bank. From a more global perspective, I think a lot of us are looking at it – the OBA, we've made no comment. We've not taken sides on it. On Brown Vitter. We've held back. Because some of our membership is saying 'screw them, let them bust out.' Don't know that that is the smartest thing. You know, for the country. But that's a real good debatable issue, and there's merit to both sides of that.

How do you – when you sit down and read this stuff – how do you understand ...

There's rules and then there's interpretations of the rules. So you try to find out the interpretations from the regulators, which is not ... it sounds easier than it is.

Well, how do you do that?

Well, it's a difficult task. Your examiners at the time will have one interpretation and you find out in the examination what their interpretation is. Now, depends on if you're a national bank, the OCC's coming in. I tell you, I come from an OCC background – they view these regulations totally different from the FDIC and the state banking commission. If you've read some, you see it's not just clear cut. I'll tell you an example. In the bank I ran before; they came out with their new appraisal guides of what were called 'valid appraisal questionnaires' – VAQs is what the regulation called it – and it had to meet these certain requirements. Well, this particular regulation was very clear – very unusual, but it was very clear – it was great. We all understood it. We had examiners come into the bank, and say that our VAQs didn't meet the requirements. And we said, we beg to differ. We have followed the regulations step by step and the lead examiner said, "That was not in our PowerPoint presentation." That's what he told us. You know, we said, we're going by the regulation, we haven't seen your PowerPoint presentation. And he said, well, as of now, you're in violation, but I'll check with our regional office. They never came back and said they were wrong – but they came back and said – we provided them copies of the regulation before they left – these are the actual regulation that we're giving you. Tell us which item we are not compliant with because we believe we are. With every step of the way. Well, that's not the presentation they got in their PowerPoint presentation, whoever did that. They differed. I said, well, we're trying to comply with the actual reg, we have no idea what's in the PowerPoint presentation. He came back and said: "the way you're doing it is acceptable." They couldn't say we were wrong – our PowerPoint presentation was terrible. They're never wrong. They'll accept our VAQs as we were doing them. The way we were doing it was acceptable.

The point is: it's very frustrating to see the reg and then determine how it's going to be – and second guess regulators and see how they're going to interpret it. One thing we do is we go to Washington DC quite often. We sit down with the regulator. And we discuss these items. How

are you looking at this? How are you going to interpret this new reg? How are you going to apply it to our banks? We'll go and sit down – for example, our next one's in September – we'll sit down with the FDIC, the OCC, the Federal Reserve maybe – the FDIC for sure – those three are absolutely guaranteed who we'll sit down with and say, OK, how are you seeing these regs? But you know, they're so voluminous – you can't cover them all in an hour meeting or an hour and a half get together. So we pick out the major and we try to get the best interpretation and we try to share that with all our member banks.

When you come across a regulation that's unclear – what do you do?

I write legislators, I write regulators. Pick up the phone and call – say, how are you interpreting this thing – they hate that – and one of the other things we're pushing for is, for a lack of a better term, is an appeals process on the exam. Right now, you appeal to your regulator. Well, how's that going to go for you. Hey, I'd like to tell you you did a crappy job, and I'd like another look at this ... so nobody says anything. I could give you an example, where we had a signed contract with the FDIC – our bank, we were buying a bank – they came to us with (the contract), they changed their mind and then went and closed the bank and went and took bids on it. After we had a signed agreement, they came to us and said, "Would you mind – at this price. We'll set off the bad assets. We'll take care of the whole thing." We spent, I will tell you, a couple hundred thousand dollars in our due diligence. We had an agreement, all parties signed it. A week before closing – we had already told employees, their employees, everything, what was going on – a week before they called and said we're going to see how we come out on the bid process. And I go, "wait a minute," we're set to close in a week – we spent a lot. They did it. We were one of the bids, there were two of them, one of the other banks got the bid. But what are we going to do? Sue the FDIC? That's the kiss of death. Next thing you know, our FDIC coverage is gone because we failed.

What's your interaction like with your regulators?

Our state regulators are terrific. If you've got a question, you can call Gilbert, you can call Mick Thompson. These people are there to help you. They're the only regulator I've ever seen – they're there to help you work through the regulation, understand it and comply with it. They're on your side. And that's the way regulators ought to be – to help you be better at what you ought to do. I would say the state is the only one we get that from.

What about the FDIC?

It's good. I mean, we've had good exams. But we don't have the trust in the federal regulators the way we do the state. We know the state – they're people who are right here. They're us. They're Oklahomans. They understand, and they understand us. They understand our market better than any federal regulator can. We have absolutely zero issues with our state banking regulators – they're great. In my opinion, they're awesome.

What do you think the difference is – in terms of performance – between being regulated by the state or national agencies?

It's easier to operate as a state bank as opposed to a national bank. Number 1, the costs are cheaper. We pay fees – we're a self-contained – your tax dollars aren't going to FDIC coverage. We support our own, and you've never paid a tax dollar toward your FDIC insurance coverage. So we pay fees, whether we're a member of the FDIC – everybody pays FDIC premiums for the insurance coverage – but state association dues, OCC, you have assessments. Your state association fees are so much cheaper to be a state bank than they are to be a national bank. Substantially different. Based on your size, it depends on how different, but it's hundreds of thousands of dollars cheaper.

I wonder if regulations are enforced differently for different banks ...

There's no question they're enforced differently. Depending on who the regulatory examining team is. They're not all on the same page. I'll give you another example. At a former employer, they disagreed with our allowance for loan loss. They accused us basically of tax evasion. Said they're keeping too much in reserve. This is prior to 2008. In fact, it was 2007. They said – because we were not taking it all to the bottom line, and according to tax law, we should have been. And our question was, 'When did you become the IRS? We thought you were safety and soundness.' And safety and soundness would like that our reserves are at a higher than-you-think level needs to be because we did because of the way we did them, there's a calculation they had, but our calculation showed that it needed to be higher. Because we would do loan-by-loan what the exposure was. So we thought it was the most realistic view. Well, it came out by their equation as a whole total package that we were over reserving. So we were told not to reserve for the next year. Well, our earnings went through the roof. And then, the recession hit. During that time, I was on one of our visits to Washington – I talked to the assistant deputy of the OCC and told them – and he was in charge of all examiners – and I told him what we were told. And if you could have seen the look on his face: 'Now wait a minute, you weren't underreserved?' He thought I was complaining about being underreserved, and I said, 'No sir, you misunderstand me. We were overreserved. We have not been – under direction of your examiners – we have not been taking any more to reserve. We have taken zero this year.' He looked at me and goes, 'That's insane.' This is the guy over all of them! Well, he reported to the comptroller. He's number two. And I said, 'I agree with you, but that doesn't change the way we live. Now, I would like professionally for you not to call your regional manager in charge of your region because I imagine they will show up Monday morning for another exam.' If you know what I mean. He said, 'I absolutely do.' He told me, 'I can assure you – we are not the IRS – we are never – we are safety and soundness.' And I said, 'That was my thought, too.' He agreed with us. However, they've got people in the field doing their own deal. We take no reserves. Well, 2008 hits, we take loan losses. Well, we're underreserved now, in our opinion. So we have to now, go back up and overreserve to make up for what we hadn't been reserving. They did say – well, on the next exam, they said, 'We'll never ask you to take less reserve than you think, as long as it meets our requirement.'

But we had to go through two years of hell. The income statement's going bingity bangity boom – not to mention what it did to our shareholders: hey, that's going to be the new norm. We made X amount of dollars. That's the best year in the history of our bank. Folks, that's an anomaly, that's not going to happen next year. Try to tell shareholders that – that that's a one-year goof. No, they get used to it real quick and expect more.

How aware are you of what other banks' interests are?

Very much so because of my affiliation with the Oklahoma Banker's Association. We just did a survey – we asked all our member banks to tell us – because I wear two hats. One is as president of my bank then I wear another hat that is what's best for Oklahoma banks by the majority. So I'll give you an example. I serve on the government relations committee of the ABA, and they've asked us – there's one representative from each state – and I'm for Oklahoma. We are setting priorities for 2014 of regulatory issues to address. I've certainly got the five that would be on my number one hit list for this bank, but that's not what I'm going to send them. What I'm going to send them is the top five for Oklahoma banks. I feel compelled and passionate to do that. I'm asked to represent them, and that's what I'm going to do. Now, I'll tell you, it will go hand in hand – maybe in a different order – of what mine would be. Example: the federal credit union – credit unions, it's absolutely ridiculous that they're tax free. They're taxed – we're basically subsidizing credit unions – they're never paying taxes. Now, the ones that have stayed with their main mission – I've got no problem with. But Tinker Federal Credit Union: they're no more a credit union – if you can breathe, you're a member. And you don't have to breathe real well to be a member. I'd like to see them turn somebody down for membership. They never have. They're building branches everywhere, they're doing commercial lending, they want their cap raised on how much commercial lending they do. And I use them as an example because they're the biggest in the metro. But there's huge credit unions all over the country.

That's an uneven playing field. They're competing for the same customers on the commercial side of the bank, and have long lost what their original mission was, which was for military people from Tinker Air Force Base. They're nowhere near that anymore. So what we're saying is take these credit unions that play in that realm, convert them to thrifts, and make them taxable. The rural area banks don't deal with the credit unions – they're not out there, they're in the metro areas. But what they have out there is farm credit bureau, which is their credit union. Farm credit bureau is tax-free, and they're competing with the same business. So what I'd be advocating against the credit unions being increased their lending limits – their commercial lending limits – they've done an end around and they always get their way. They've got a lot of support in Washington. The rural bank would think, they don't care about the credit unions. But they do care about the farm credit bureau. Because farm credit to them is what credit unions are for us in the metro, so I lump them together. We need to do something about credit unions and farm credit bureau. Because I can tell you David doesn't – I would be shocked if he told you he has to compete with credit unions – but he deals with the farm credit bureau all the time. They're in the same game.

Do agencies seek their input on new rules?

There's always a comment period for the new regulation. We write letters, and we give our input. There's one state that sends more letters than Oklahoma – and look at our population in comparison. There's only one (I think it was Ohio). Everytime, we are – and the regulators tell us they hear more from us than they do from anybody. We've got some apathy in other states. Why, I have no idea. It makes no sense. We believe in Oklahoma that we're fighting for survival. It's a war to survive. We have the right to survive as a community bank. To take us away would be

detrimental to our communities, we believe. And other bankers at conferences I go to will agree with that, but they're not doing anything about it.

We want to work with them (regulators). We'd love nothing better than to sit down and say, here's what we face. Here's our issues. You tell us what your issues are, where's the common ground here? We can find solutions. But you can't just paint us with a brush and say, by God, that's the way it is. That's exactly what happens – I watched the number two guy from the consumer financial protection bureau do a presentation at the last conference I was at. If I wouldn't have gotten arrested, I'd have gone up there and hit him in the mouth. Because he was so arrogant in his presentation – he was, it's not any two way – this is how it will be. Now, we don't want to hurt anybody in the process, but if we do, that's just part of it because we're out to protect the consumer. When actually, they're a bunch of consumer advocate groups that got together, and it's not just about the consumer, like they're trying to make it out.

Sheila Bear, when she was the head of the FDIC, which she is no longer the head of, thank God, that she told Oklahoma, as an example that our community banks were more predatory than payday lenders. Can you imagine that? Can you imagine how that riled us up? They don't have the courtesy to work with us, and she says something like that? Oh my God. We were coming out of our chairs. Really? We're more predatory than payday lenders?

Question about frame.

I'll give you a good example. People in other industries – in fact, we had a discussion not too long ago, there were some attorneys sitting around, business owners – we kind of reflected back and said, 'Remember when we were kids, that you looked up to the Honorable So and So who was a senator or congressman to – we were just in awe of the government. They were our government. We were proud of our government. We'd go to war for our government. Now, it's just wrought with criminals. With everybody's that got their hand out. I don't know where that change happened, or if it did, and maybe if we just became aware of it, but somewhere along the way ... well, congress has been rated lower than it ever has been in history for quite a while now. There's no trust in them. They don't know how to be good with the money they're given. They spend – just like crazy spending – on unbelievably silly stuff. Now, that's probably happened for a long time, but it's gotten bigger and bigger and bigger, and people are tired of it. And people are finally saying enough's enough. And people are finally getting to where they don't trust the government. When every day you see on the news that they're spying on us all, the NSA is doing this. How are you going to trust that?

Do you think this affects how you think about groups like the FDIC?

There's no doubt.

The state agency seems to get a pass.

But the difference is, they'll talk to us. They'll deal with us. If we have a problem, they'll help us with a solution. We know – and this was not built over night – but over years, and Mick Thompson, who's been the commissioner for so long, that's his approach: how do we deal with

this. Not how do you. We. How do we deal with this? How can we help, and here's what we can do. We come together, and we work on it. If a bank gets into trouble, he doesn't just go out there and threaten them and start slapping stuff on them. He says, OK, guys, lets sit down and work through this thing. Sometimes its successful and sometimes its not but he tries. So his whole office takes this approach.

Do you see faces or faceless entities?

You do, but it's not as personal. You don't sit down and have a beer with one of them. You don't let your hair down and say, here's what we're really fighting. Number one, I would never say that because you'd be scared about the retribution. It's always in a very formal setting. It's always a limited amount of time – that they set, in their terms – and they put on their little dog and pony show for us. We get to ask a few questions, and then our time runs out. I get it – they've got fifty states coming at them, and I get that, but I don't know if they really care about their reputation or how we view them because they're God almighty. That mentality has to change. They need to be part of the solution and not just the acknowledged of the problems. And oh, here you go, here's some more new regulations. Good luck to you. We'll be checking next time we're in.

Interview 3

How long have you been involved in banking?

I came out of college in 78, so I've been here since 1978. Do the math, I haven't. 30 some years. Started out in the operations side and moved over in the management side in 1983.

Family business?

Yes. My granddad bought it in the mid 40s. My dad worked here until he passed. I worked here until college and came back.

Always been a state charter?

No. We converted to a state charter in the mid 90s. We were a national bank in the 40s, when my granddad bought it. The biggest reason we changed is because of the regulatory environment. In the 80s and 90s, national banks were examined by the comptrollers office – the office of the comptroller of the currency – and we just got the feeling that comptroller really didn't care about small rural community banks. That wasn't their forte, and they would almost have a hostile feeling whenever they would come out and examine us. They didn't really understand what community banking was and we made the election to change to a state charter.

Had you always felt that way about the comptroller?

No – there was a change there in the 80s and 90s that we felt like they just ripped us. For years, this bank was a model bank, and the OCC would bring trainees and show them what a good bank looked like and bring them up to speed, and I bet you we had four different training groups

through here when they did an examination the years prior. But like I said, something changed in the 80s – late 80s, early 90s – there was a shift, whether it was out of the field office in Oklahoma City or higher up. They just was not a good fit, and we got tired of banging our heads against the wall trying to deal with their whims and wishes.

More and more banks are switching over to state charters.

Probably a two-fold reason. One is the regulatory emphasis. Two is a cost saving factor. It is much cheaper to be a state bank and be assessed examination fees based on a state charter rather than a national charter.

How does the fee structure work?

I really don't know. I just know that it saved us thousands on thousands of dollars to change. But from a cost saving factor but also feeling like you've got a regulatory body that understands and comes in as a tool to help rather than a tool to detract and destroy, and that's the feeling we had with them. Now, we get examined, we're not a federal – so we're what they call a non-member. We have dual examination – we still have federal oversight from the FDIC – but what we've experienced when the FDIC comes in and examines, they're much more like our state banking commission examination, and they're here as a resource/tool to help. Now, the FDIC will tell you in very forthright, helpful hint, this will be done before we come back next time. As long as you comply, then they see you're making steps to improve/comply, management's up to speed, and they don't seem to have any heartache over that.

As a state bank, you've got the state commission, the FDIC. How would you characterize your regulatory environment?

Other than just not knowing what new rules or regs are coming down because of the implementation of Dodd-Frank, which should have never been passed in my opinion, a knee-jerk reaction by policy makers to something that shoulda shaken out and would have taken care of itself through the regulatory environment we already had. But they had to show they were doing something to fix the problem, and all they did was create a monster. So, from the regulatory environment standpoint, it's very confusing and makes us very apprehensive about what's coming out. From an examination process, what we have seen from FDIC especially, is they're giving some leeway and time to come up to speed to the new rules and regs. And they are encouraging us to call the field office and visit with somebody with expertise in that area for guidance so that when they come out, they've already crossed the problem. I don't know that OCC – maybe I'm just being sour grapes on OCC, but visiting with other bankers in the association at different meetings – I don't get that feeling from them that OCC is helpful in that regard.

They'd almost rather let you break a rule so they could come back and get you.

It's almost like a gotcha. What I've experienced.

With your interactions – do you personally handle the intractions?

We run this bank on a management team. We have seven board members and five of the board members are officers in the bank. Probably my CFO, my vice president, the cashier and myself probably have most of the interaction with the regulatory environment.

On the regulatory side, are there individual who you know on a name-to-name basis?

Yeah. And it's just – the chief counsel for the state banking commission – we could pick a phone up and call him and bounce an idea off him. Dudley Gilbert. We call him quite a bit. Even in the FDIC, Don Fitzwater, anyway, there's two or three guys in the FDIC.

So it's not like the IRS: you get a letter in the mail. You see individuals?

Yeah.

What role do these agencies play in industry performance?

With the promulgation with some of the rules that they've handed down the last few years – especially with overdraft protection and overdraft programs – banks generate a lot of income based on fees. One area that is very fee driven is overdraft protection and NSF plans. They have reigned back in some of that ability to collect fee income through some new rules and regs that they have passed down. Other than that – they have basically, the regulatory environment, forced us out of making residential real estate loans – for us, we quit offering residential real estate loans primary dwelling in Januar 2012 because of the requirement that if you charge X percent, and it's considered a high-priced mortgage, then you have to offer or you have to do escrow – or taxes and insurance. Whenever we originate maybe five primary dwelling real estate loans in a year we can't go buy an escrow program to justify the cost. And we were to the point where if we needed to price the loans where we needed to price them, we couldn't lower that rate any lower to offset what we were paying – we gotta make money on the loan side so we can pay out money on the deposit side. We try to keep our interest rates up that we're paying to depositors to a certain level, so we're not squeezing their potential income. Anyway, those never did balance, and we either had to make the determination to do escrow or originate five loans a year and sell them to the secondary market. And nobody's going to want to come out here and buy a residential loan at \$35,000 – and a lot of the houses out here, that's what the average price is on what we were doing. So we got out of it. Because of the new real estate lending new rules and regs that forced us out of that market, which cost us some potential income. It wasn't a big balance sheet item, but it was something we did make some money off of.

Other than that, on the other side, the time and money and effort spent of trying to stay up to speed with all the new compliance rules and regs as result of Dodd-Frank. I mean, basically, my brother Todd, our cashier, serves as our compliance officer, and for the last year, that's about all he's done. He's not generating loans, he's just trying to keep up with the new compliance burdens of Dodd-Frank, making sure policy and procedure is in place because of that.

And I'm sure we're not any different from any other bank in the state, other than we have limited resources and people, and we can't afford to hire full time compliance, so we try to do it in

house. The regulatory environment has forced us to – at the suggestion of FDIC – of hiring an outside compliance auditor. We have a lady who comes in and reviews our compliance efforts three times a year, does training, does an exit meeting, because we can't devote the time to do that part of it.

The rule book? How do you know what's in it?

We rely on the OBA, the ABA, to give quick bullet points. Their staff goes through the – Mary Beth Guard at the OBA – is our legal counsel and compliance expert. Bankers Online, which Mary Beth started, now going through the new rules and regs, and make quick bullet points of things you need to address, seminars. We rely on our outside compliance officer to stay up. She tell us the things to do to stay in compliance with this. So it's a combination of Tom sitting there at the computer reading the new rule and reading the comments from OBA, ABA, BOL ...

Are bullet points sufficient? Seems like it might not be.

When you sit down and read a new promulgated rule, part of that volume of paper they put out is they give you the complete background as to why this law was ever in effect. What the proposal will do. They put it out there for public comment. And this is their take on the public comments. Then they finally get to the guts of what the final rule is. So try to read through all that? And by the time you get down to the new rules? Well, I'm tired. I don't want to read that. So they put – out of the new section – these are the bullet points they are addressing, you need to pay attention; but depending on your banking complexity, some of these rules will apply and some you can brush over. And it's up to us to determine what we need to change to stay in compliance for our bank. Because they'll issue new rules and regs and they'll say this applies to banks a billion dollars or more, or this applies to all banks under a billion dollars. On that stuff that says a billion or more, we don't pay attention to. Other than to know it's out there, and if the beast is out there, it can always penetrate down.

Is it easy to understand a written rule?

For the most part. Some of it's – some of it is confusing.

If there's any ambiguity, is it in the written rule? Or is it in the enforcement of the rule?

Usually in the enforcement. What we have seen – or what we saw early on – is that here's a rule black and white, and now the examiners read it and they've got to be able to apply a grey area. Some examiners don't have much grey area thinking and unless it fits here, you're not compliant. And that's what I refer to – on something that is maybe a little ambiguous – not quite clear – I have found, especially from state, or the FDIC, that they give a little leeway. You may have tried, but you missed the mark. Go back and tweak this, send us what you did or how you addressed it.

Are you proactive – will you reach out in advance ...

Yeah, Todd does a pretty good job of that. If he just can't grasp what they're saying, he's making a phone call either directly to FDIC, state, or to Mary Beth at the OBA on what her take is, what she thinks the intent is. The guys from Oklahoma City in the FDIC office – they ship them to DC from time to time and give them training – but they're not any different from us. It's just that they've been an examining force for a while and they kind of have an idea. Sometimes they miss it. And then the FDIC will come back out – the head office will come back out – and give guidance to the examining force: This is what we intended. What we're hearing is that you're enforcing it too far this way, and this is what we intended. Here's guidelines for your examination process, and we do pay attention to that.

How relevant are regs in the day-to-day?

Well, you gotta know what the regs are fairly well to know if what you're getting ready to offer is going to be allowed. What area does it fall? I'll be honest, in our bank, we're not looking for new products. We're a pretty plain Jane, vanilla organization – we don't assume much risk, and we don't take much risk. And that has been the mainstay since the 40s when my granddad bought this. I mean, we'll meet the credit needs of the community, but if its too risky, on the loan side, or if it looks like a risky investment, we'll stay away from it. So new products – other than something that's been tried and tested out there – we don't bring in.

Do you feel like your range of options are limited by regs?

Nah. I don't know if they're trying to pass rules and regs to limit business opportunities. I think they're trying to pass rules and regs to appease the consumer advocate groups not to screw the consumer. But. The consumer advocate groups don't represent all consumers: they represent a vocal minority group. The old proverb: the squeaky wheel gets the grease, you know? You take the overdraft protection plan – you go out and ask consumers: would you rather your bank pay a checking overdraft and charge you a fee or bounce your check? That's the two options you have. And they're going to say we want our bank to cover our check – we'll pay whatever fee we have to pay. But the consumer groups are saying, no, you're double charging them. But there's a cost to pay it and assume a risk of not collecting that overdraft as opposed to turning back. They get to deal with the DA – the charges, a bogus check charge – and you think the bank's charges are exorbitant, try facing what the DA imposes in terms of fines and penalties for a bogus check.

How do you know when regulatory change occurs?

Those agencies will send out advance notice.

Do you participate in the comment period?

Sometimes. If its something that directly effects us, and we have an opinion, we'll post a comment.

Example?

It'd probably be in the real estate lending process, when they were proposing going to a high priced mortgage and enforcing escrow. That was probably back on the heels of the financial crisis – 08. In 09, they'd start coming up with these rules. Our comment was: you do this, and you're going to drive small, rural community banks out of the real estate lending function. And now, they're starting to see what happened, so they're going back and making exceptions to those because they have recognized that there are hundreds – approaching perhaps a thousand – of banks that have quit making real estate loans in small, rural communities. And the real estate market is being driven upstream to the bigger banks that don't want to come into the heart of America and make a \$50,000 home loan. Your BofAs, your Wells, your JP Morgan, they're wanting \$100 thousand and above real estate loans. So they're starting to relax some of that. That's just once instance, we wrote a comment stating that we thought it would be detrimental to rural communities.

Do you think rules are enforced differently by different agencies?

What I have experienced lately, no. Very seldom do we have the same examiners back again. We just got done with a compliance exam. One of the examiners had been here prior, but not the last time. The way they went through it, the outcomes, their decision-making process had been pretty uniform. One reason we left the OCC was that never happened. One set of examiners would come in, and we were fine. And another would come in, and they would just hammer us on the previous exam. It was just really frustrating. But so far, in this new regulatory environment, have not seen that.

Are sometimes of your interactions more interactive than others? Are regulators always strictly interested in enforcing regs?

As far as complying with the strict letter of the law, there is no give and take with compliance on a law. If you violate a law, they will cite you. Now, there's give and take on following policies and procedures. When they come in for an exam there's one component of the examination, the CAMEL rating, on management. And they will – CAMEL's capital, asset, management, liquidity, I forgot what the e is – one of the components of the CAMEL is management. And they will rate management as to their overall ability to take care of capital, asset, risk, interest rate risk, liquidity, needs, and part of that is policies and procedures. They expect you to have all these policies, but if management has decided that that policy is not needed in this bank, it's not a violation of the law, but it could downgrade your management rating from a one to a two. But there's a give and take there. Sometimes they'll come in and see, you know, really for your complexity and size, maybe this policy isn't really needed. As long as you know what should be addressed, if you haven't reduced it to formal policy, then they may give you a little pass there. As far as the letter of the law, if it's a law, you have to comply with it. If there's a deficiency there, they'll say in the exit meeting, we noticed this deficiency, it's a technical violation, we need a management response about what you're going to do to rectify it. And then the next time they come in, you had better had it taken care of.

How often do you interact with the regulatory players?

Bankers go to the OBA functions, bankers night out, some seminars, the convention – Mick does a pretty good job about coming out. Dudley, who was there this past spring. You have some social interaction with them in that regard. Now, have I ever just, on my way to the city, just stopped in and said hi guys? Well no.

Do you buy the value of the relationship?

Yeah. In some respects, early on, with OCC, I felt like we had that. They brought those trainees out here to show them how a good bank should be run. Because they'd been in bank that were not so good and every now and again, they'd bring trainees out here. There may be two seasoned examiners sitting back there and four or five trainees. And so that relationship was built there, they knew this was a good bank, they would use that. I've made recommendations to other banks in this area that were considering changing national charters – Texhoma, out there in the panhandle, was a national bank longer than we were – Paul Freeman called me one day and said, do you think we need to make a change? I told him I don't think he'd live to regret it. Well, next time Mick saw me, he says thank you. Your comments helped. You know, the state banking commissioner wants every bank in the state to be a state bank. It's the state banking commission isn't a state legislated item – they're self-funded. And they've actually been able to reduce our assessment because the number of banks coming in has increased.

Do you feel like you've gotten better at doing the relationships?

I think we've got to maintain some sort of personal relationship. Being able to pick up the phone and call Dudley. We used to call them all the time. Got to have a contact where you can bounce something off them. We're thinking about doing this, are we out of line?

Have you been successful at changing a rule/policy/enforcement?

Probably not me directly, personally. But through the lobbying efforts of the OBA, ABA. I mean, if I call the director of the FDIC, and say, man, you missed the mark, he's not going to listen to me. It's going to take some type of lobbyist association representing thousands of banks. I mean, I can write a comment and they'll read it. And they'll segregate it – these are comments in this line – and they do listen to comments. Probably they look at comments more from the big players more than they do some \$65 million bank out in the middle of nowhere.

Can you think of an example – the OBA – regulation loosening?

No because what OBA tries to do during the bill markup period, when bills are introduced on the floor of the house or senate, our staff puts together a tracking – a quick synopsis of what the bill intends to do, and then our government relations council sits down and reads through that. And if any of those proposed new rules are germane to the banking industry – if we think it's going to be detrimental or squeezed to hard – we're going to kill the bill before it's introduced. And we've been very successful over the last two or three years of working with the author to change the language to where it's not detrimental. Or to convince the author, I know you need to introduce a bill, but this is stupid. You don't need to do it. And that kind of works hand-in-hand

with Mick in the state banking commission – whatever the legislature passes, Mick has to enforce.

The state agency is your shield against the Feds. Does Mick speak up for you guys – in dealing with legislators?

I think him and Roger and Adrian talk back and forth. The commissioner puts forth his own bill every year. Things he wants changed or things he wants to change. And asks for the OBA support in passing that. At the same time, he's gone through it with Roger and Adrian and the staff. But you know, there are some things that happen at the Federal level that he has to address at the state level to where he can keep his enforcement in front of Federal. That's where he introduces the commissioner's bill. From time to time, a representative or senator, at the request of a constituent puts forth a bill on something the constituent felt he was getting screwed, and the OBA says that's just a stupid idea and kills it.

How worried are you about blowback?

I've heard others say it. I haven't gone out there and filled out an examination survey. You get done with a compliance exam, and you can go out there and give your feedback on compliance. Oh, it was terrible. It was good. They really hammered us in this area and were concerned in this area. It allows the state association to get a feel for how the different regions are enforcing the rules and regs. And as long as they can assure us that its completely anonymous – that there's no way – if one of the questions in there wants me to specify my asset size, I usually, respectfully, decline. Because I don't want a chance that the FDIC will get ahold of that information and they can figure out what asset size was recently examined, and they could, if it was a harsh, negative feedback. Now, FDIC when they send their report out on the compliance exam, they have a survey in there where we're supposed to critique them as to how the exam process went. If we've got any bitches or complaints, we can respond directly to them and say you missed the mark here, you were overly harsh in this area, or this was a good exam. They want that feedback directly to them, and it does go through the field office, the regional office, right up to DC.

Have you ever tightened?

In some areas, the farm credit system is a very strong competitor. For the last ten years, I have lost maybe two customers to farm credit, where I feel like they went out and cherry picked a good customer and offered them a better interest rate than I could offer. But what I have found with our Woodward office – the federal land bank – we've kind of worked hand-in-hand. I really don't feel like the guys out of the land bank – I know they're actively pursuing – but if we do a good enough job meeting our customers' needs and don't gouge them on interest rates, they're pretty loyal. Now, I've worked with them. I've had customers come in and buy a big tract of land. We're really not set up to offer a 30 year purchase on a big tract of ag land. That's what land banks do. I'll send them over there. What I don't want them doing is going over there and getting their operating line. I can take care of their operating line here, if they'll finance their land over there, that leaves them room to finance their operations here. As far as tightening rules and regs, the only tightening I would want to see is kicking the credit unions out of the no taxation. If they're a small credit union serving Oklahoma educators, and you had to be a

teacher, or be employed by the school district or university to be a member, that's fine. But it's the credit unions that say, if you're living and breathing and you know somebody that's in the military, then you can be a member and now they've gotten bigger than any bank. They're getting a federal subsidy in the form of no taxes. That's got to be changed.

There's other banks in other areas of the state, those [farm credit] SOBs are cherry picking me.

Framing?

The banking industry has always been an industry where there had to be rules and regs. And it probably started from the 30s depression, was when a lot of these rules and regs came forth. I don't have a problem with rules and regs. It makes all the banks compete at the same level. But some of the stuff that they're promulgating today is overkill. We've fought tooth and toenail, OBA did, when they first rolled out the Consumer Financial Protection Bureau, a brand new agency spun out of thin air – and there wasn't any need because all the rules and regs were already in place through the Fed, FDIC, and OCC. You already had every bank in the nation regulated. Why do you need another agency promulgating rules, which is exactly what happened under Dodd-Frank. CFPB writes new rules and regs and pushes them out to the OCC, FDIC, and Fed, saying this is the rules and you've got to examine your banks by them. 10 billion dollars and above is all they go in and actually examine, and yet they're writing all the rules and regs for banks under 10 billion.

The CFPB is more compliance – safety and soundness – from what I've seen, I can't think of anything they've promulgated that's safety and soundness issue, other than trying to rein in some of this exotic mortgages.

I think [this frame] is throughout the industry. By nature, there's very few bankers who try to figure out a way not to comply. I think most bankers have in mind that we need to comply with the rules and regs that are out there. We did not screw the customers. We can't harm them. And that's what the rules and regs are for. This onslaught is just overkill and should never have been spun up.

Brad Swicky's theory that we need to have a bifurcated regulatory system. Your big six players and banks at 250 billion and above – whatever that magic number is – need to be under OCC. That's OCC's expertise is those big banks. Any bank under that ought to be a state chartered bank with Federal oversight, either with the Fed or FDIC.

Interview 4

How long have you been involved with the bank?

I've been here since 1991, so 22 years.

Family?

I'm a third generation community banker. My grandfather didn't start the bank. This bank was established back in 1896, we're about 115 years old. My grandfather purchased controlling interest in the bank in the early 20s, and worked for the bank for 50 years. My father worked for the bank for 50 years. I'm in year 22, and my brother works with me now, and he's in year 12. So it's a pure family operation.

State charter?

We've always been a state chartered bank. Of course, we were established in 1896, so we were here before statehood. There were no charters back then, but we got our state charter in 1907, I guess, when we become a state. And we were rechartered after the moratorium in 33. We were the only bank in Noble county that was allowed to reopen without recapitalization after the moratorium. So we can advertise and market that we have been in business since 1896. Whereas, my competitor was – not a bad thing, there's two strong banks in this community – but they were not allowed to reopen. They had to recapitalize and recharter. So their charter says they were established for 1933 although they'd been around longer.

What do you think the implications are of a state charter?

First of all, I'm a big fan of the dual banking system. What we find is being a state – what makes it great for us to be a state charter is, number one, a certain degree of pride associated with being part of the state of Oklahoma and being regulated in part – our primary regulator being the state of Oklahoma. Secondly, it's the relationship building – it's a whole heckuva lot easier for me to go down and get to know a bunch of Oklahomans and the state bank commissioner than it is for me to get to know Ben Bernanke. You know what I'm saying? I can't fly up to Washington and make a spur of the moment appointment with Ben and talk to him about my problems on Main Street. I can do that with a telephone call, a text message, or a trip to Oklahoma City to see our commissioner Mick Thompson. There is an enormous amount of value with that. Mick Thompson, our bank commissioner grew up in a small town in Poteau, Oklahoma. He has a street named after him. He was a community banker. He understands community banking. He understands what makes us successful and what doesn't. He speaks our language. No disrespect to Washington or Bernanke or anybody else. But, you know, they get Potomac Fever when they get up to Washington, and in my opinion, they lose sight or lose track of what drives community banking. State bank charters that fall under the regulatory burden of the state banking department – they get it. There's a great deal of value there. Additionally, and I might have said this, but there's not enough I can say about the relationships. I'm on a first name basis with our bank commissioner. I've got a placque on our wall that last year, we were named by the American Bank Association a top 100 performing banks in the United States of America. I get a personal handwritten note from my bank commissioner. Do I get anything from the Feds? Nothing. That's just an example of somebody who's in tune and knows what's going on.

We're not regulated by the OCC at all – thank goodness. That's about all I'm ready to go on the record with.

Regulatory environment? Fed member?

All banks are, of course, going to be insured by the FDIC. We pay a premium and, in the current environment, the FDIC found themselves under insured and we had a special assessment that we had to pay. So we're all insured by the FDIC, but I'm not regulated by the FDIC because I joined the Federal Reserve system, and you do that by the purchase of stock. We bought stock in the Federal Reserve. Each Fed member is a stock holder in the Federal Reserve. We get a dividend from our purchase of the stock – it's a statutory dividend, so it's not driven by the market or by book value or EPS. But once you join the Fed system, then you become regulated by the Fed, and the FDIC is not your primary regulator on the national level.

The Fed does safety and soundness as well.

Who's doing the interacting?

Great question. No. It used to be, even when I started, I can talk to you like an old timer because I've been here for two decades now, but it used to be in the old days that you could be a jack of all trades in the bank. The president and CEO really had his hand on everything and was the primary point of contact for the regulator. Banking today has become very very specialized. There is no way that I have the time or ability to become specialized in all the areas I would need to be to be in compliance with the regulatory burdens that we're up against on a daily basis. So in answering your question, I would be considered as the primary contact. All Federal Reserve information comes to me directly. All state banking notifications come to me directly and then I disseminate those among my staff. But particularly, the state, because they know us and understand us, they know if it deals with asset liability management, I've given that responsibility over to my brother. My brother manages an \$80 million investment portfolio. He's responsible for the day to day interaction with asset liability management. So if they're calling with regards to risk weighted assets, investments, how we're managing through a yield curve that may be steepening, they know that I've divested myself of that and they'll call him directly. Ultimately, I'm going to be responsible for it, but they're going to call him directly because I just can't stay on top of it. Additionally, if there's changes in mortgage laws and mortgage regulations, they know I have two mortgage departments – one in Stillwater and one here in Perry – and they have those names and those contacts and they'll call them directly. If something comes up, if we're in violation, if we're doing something they would like to see changed, then they'll report that to me. But they understand that I can't be a specialist any more in the bank.

Regulations – operations match? Is that unique to your bank?

I doubt it. I doubt it's a unique model in today's environment. Now, we're a \$240 million bank. I think you need to judge this by the size of bank. If you're out at Laverne, and you're at a \$35 million bank – look, I'm running on 60 employees – they probably have five. That guy can still manage and keep its pulse – and probably would want to – he's probably in charge of the investment portfolio, the loan portfolio. He may have a compliance officer but I bet he's meeting with him or her on a regular basis. But the larger you get, the more you'll see these responsibilities spread amongst the staff.

Consultants?

We rely on them like crazy. And that's only really started in the past 10 or 12 years, when there's been a real crisis on compliance related issues, and us not being able to stay up on this. We bring in loan specialists, we bring in compliance specialists, we bring in investment strategists, and then we have an internal auditor, an external auditor, and then we do an annual board audit. So we have specialists that come in outside of the bank regularly. We have to – we just can't stay up on it.

Characterize your relationships with regulatory agencies?

It's interesting. We actually – we've gone through an interesting cycle – I've been CEO and chairman of the board during our worst examination in this bank's history. And I've been CEO and chairman of the board during our best exam in this bank's history. Worst exam came about 15 years ago. Best exam came this year. I think that there is one thing that has fundamentally changed – when my grandfather and father were here, they looked at the examiners as a pain in the ass. These guys come in, they start snooping around, they try to run your business. There's no way that they know – these are hot shot little kids coming out of college. They've never been in a bank before. They're black and white. They're reading a book. They don't know what it takes to run a bank. When I took over – that's the philosophy I lived with because that's the philosophy I grew up with. And guess what? I experienced the worst exam in my life because my attitude was “You bastards.” I've gone through a great change – and in answer to your question, I do believe that they are here to help. They have a job to do. Their bosses are telling you these are rules set down through Basel or through congress and we are the police, and just like the main street police, they are here to help. They have to uphold the law, but they're here to help you and to guide you through it. For years, look, they get gold stars if they find some things going wrong. That's how you get promoted in the organization. I don't think that's the case any more. I don't believe that. I think they have a job to do. I think they value and look upon a good, well operated bank through rose colored glasses. And when they do that, you build a relationship with them. What I've seen now, since now we've had one of our best regulatory years, in the history of this bank, I've seen now almost a switch where now, instead of them coming in and their saying, here's what you're doing wrong, they want to know how you're doing it. Because I think they use that information and pass it along to their banks that aren't doing quite as well from a regulatory stand point. I think they say, look, we have other banks that are doing X, Y and Z and they're telling their other banks that aren't rated quite as well, here are peer examples, and they use us as those examples. And so, when you get on that level with them, a couple of things happen. One, you develop a good relationship. Two, they don't look at you quite as hard because they begin to get confidence in the management of the bank and they have other places they need to be where they have less confidence in bank management. And so, we've seen our exams not get easier so much, but they're quicker and rely more on our strategic thinking as opposed to the black and white of the law itself.

To bring it full circle, I think our relationship is better than ever, and I look at them more as friend than I do foe. And because of that, I think you've seen our examinations go a lot better because I see them more as a help than a hindrance.

State commission's role as a shield?

I think that has changed. It depends on the leadership in the state banking department. Mick Thompson will go down in history as the best bank commissioner that we've ever had in the history of the state of Oklahoma. And the reason that he is that way is because he was a banker first. We've never had a bank commissioner who was a banker. We've always had someone who was either a regulator or a politician. He was a banker first, and so he gets it. We're on rotating cycles on Fed exams and state exams. Every 18 months we have an exam. It will either be the state or be Fed on the off cycle, so we only see the Fed every three years. Because the Federal Reserve accepts state bank examinations. I can see why Dudley would see himself as a buffer because – there's been many cases in which the state has fought for me. We get a Fed report in that I didn't necessarily agree with, and I would call Mick, and say, "Here's what they're saying," and you've got a well-respected state banking commissioner that's contacting the Federal Reserve on my behalf and walking through this and talking through it and it has paid dividends. It really has.

How do you know what's in the rule book?

Basel III just came down last week – 973 pages. It's crazy. We talk about this with the regulators a lot. What we ask for more than anything out of them is regulatory guidance. If they have a downfall at the Fed level, it's with the regulatory guidance. These rules come down from Congress and they're implemented all at the same time. So you have banks that have to comply with them and regulators who have to enforce them, all in the same day. So we're trying to learn the law and comply with them. They're trying to learn the law so they can enforce them. Just like in the bank business, you've got these regulators, and they have their own different departments, and they all have their different ways of interpretation of the law. So their interpretation of the law could be different than the states or than ours. All I ask for – I'll comply with any law they send down. I'll comply with it. Just give me the guidance on it. Tell me what it is you want me to do.

For example, we knew that we were going to have increased capital requirements through Basel. We knew we were going to have that. And during this last exam, they would come in and the increase capital requirement is now six percent, for leveraged tier 1 capital. And we go, no it isn't, Basel hasn't been passed yet. And they go, well, you need to be in compliance with Basel. But I said, it hasn't passed yet. So I said, how can you expect me to be in compliance with something ... and they say, we know between now and the next examination it's going to happen. And you just throw up your hands. I want to follow the law. The laws on the books. But you can't make me comply with something that's not even on the books. And by the way, Mr. Young Examiner, why don't you explain to me the capital requirements. How are they calculated. Well, they don't know. You know why? They haven't seen the law yet. It gets kind of frustrating.

So what I ask for – and the Fed was just in after their last examination, wanted to talk to us about how's it going, and said you're doing great – I just want guidance. When you come out with a new interpretation of a law, you send it down in the form of written guidance, we'll evaluate it. We'll follow it. I'll follow the law – I have no problem with that. But I can't have an arbitrary examiner coming in here with his own interpretation of a law that hasn't been written yet. It's frustrating.

How do you understand the law?

There's certain basic standards. There's an enormous expense with compliance. Generally, there's compliance programs that come out once a law has been standardized, and the compliance programs are built into our computer systems so that flags and notices will come up as we enter data and inputting information that keys us to make sure we're in compliance with the law. Additionally, as you already alluded to, we have outsourced compliance audits where they're regularly coming in and we do regular training on that. This is pretty close to true: We have so many regs now that they run A through Z, and they're beginning to renumber the regs, so you have reg AA, reb BB, reg CC, so they're starting all over again in the alphabet. So they are difficult to stay up with, but, again, we have these systems in place that red flag us.

Do you spend much personal time reading law?

I read them when they come out. Not word for word. Most of us, at this level, we get the Cliff notes. I don't have time to – I tell my people 'Tell me what I need to know. Give me the synopsis. What does this boil down to?' So I get that, and we bring in training to specialize and make sure we're at full compliance. Additionally, all executives attend regular Federal Reserve updates, state banking updates, and we utilize our state organizations and our national organizations – the ABA, and the OBA—we depend on them for training and to tell us what we need to know. They'll send out notices – again, we get publications – this is a weekly publication I get called the bank advisor. And this one particularly is on safety and soundness. So weekly, I'm reading the concerns that the regulators are having and the problems that banks are having in dealing with bank regulation.

Are the rules clear?

There's a lot of ambiguity – particularly out of the Fed. They're not clear at all. Again, that's what creates a lot of this expense. Because we have to have people who come in here who specialize in this to train us on what it's saying. And so, no, it's not clear. And you really don't even know from a compliance standpoint of what the Feds are going to key in on exactly. We could have new laws and regs come down that they're not even going to look at for six years because they're not going to interpret it. It takes them a while to interpret the law. It takes us a while to interpret the law. Both sides get that. And it starts to clear up over time, but in the initial stages, it's pretty bogged down.

How do you work through it?

We generally try to get consensus through the specialists that come in and help us and try to nail it down pretty close to what we think the interpretation is going to be. And then, if we come in and for whatever reason we've misinterpreted, we have a paper trail of our best practices, our best efforts of our trying to comply. I'm not going to tell you that that always meets the mustard. But 99 percent of the time, the regulators will go, you all have made a real effort to try to be in compliance with this. Now, while they might make a special mention that you were out of compliance in a particular area, they may hold off on making it a violation of law because you've

tried so hard to do it. Where you really get yourself in trouble is where you thumb your nose at it and say I know what it says, but I don't care. I'm going to do it this way. That's where you really get in trouble, and that's where we got in trouble on our worst examination we've ever had. Because we would have a law come down, and I would go: it's stupid. It's bad for our customers. It's bad for our shareholders. I'm not going to do it. And they – don't appreciate that at all.

The risks aren't so high – there is some give and take. But look, there are some still bad civil and monetary penalties for blatant errors and misrepresentations. We haven't talked about misrepresentations, which is more along the lines of Sarbanes Oxley than regulatory compliance. I'm not misrepresenting my financial condition for any amount of money. We cover that through directors audits, internal audits, outside audits and through the posting publically of our statements, and that's more along the lines of Sarbanes Oxley, that's misrepresenting your financial condition. We don't do that. That's where – there's zero tolerance for that on both sides of the equation. I'm talking about regulatory compliance – what this barrage of regulatory issues. They recognize that there are so many things, we're going to miss one. Even on my best examination that I ever had, which I just had three months ago, I still had violations. It's just going to happen. You can't help but not have some. But they see the best practices and the efforts and management's commitment to following through on compliance.

How have you improved your ability to stay on top of the law?

At the time of our worst examination – and even a few years after that – we did not take advantage of the consultants that were in the market. To me, it was an additional expense, I felt like we could manage it ourselves. And I came to a point and realized that we can't manage through by ourselves. We took in loan consultants and compliance consultants, where we could spend the time with them and they could spend the time with us to get control of it – and make sure our systems were in place to be compliant. That's truly what changed is me taking advantage of the professionals out there in particular areas.

In your day-to-day, how relevant are regulations?

That's a trick question. I assume that we are in, by and large, complete compliance in everything we do. The decisions that I make generally speaking from having to be tuned in on what the laws are related to investment strategies, and particularly capital levels and liquidity – liquidity management and capital management, that sort of thing – that has a direct impact on what I do daily as it relates to the law. The other things, as it relates to the consumer stand point – I make an assumption that we are compliant, and that's not going to change, unless our exams start looking different. That we're operating under the law and under the regulations, so I don't really take those into consideration so much as I do the investment strategies and capital, liquidity type issues.

What about new products and services?

Look, no bank is creating anything new. We all – I don't care who you talk to – you can talk to the biggest bank in Oklahoma, you can talk to the smallest bank in Oklahoma. We have the same

products. They may have a different name on them. They may be packaged a little different. But all in all, they're the same products, and guess what – sometimes we buy a product from a vendor. They're all going to be shrouded in a compliance package, so when you buy that you know that the compliance package is in place. It's generally been researched and studied, and the vendor, whoever is selling that, is in full compliance with the law. And generally, they will disclose that when you sign on.

Do regulators treat all banks equally?

Well, yes and no. And I think it's the nature of the beast. We talked about it a little bit. I think we are not allowed to talk about our CAMEL ratings – as you're probably aware – so let's just do a hypothetical. If you take a bank that's a CAMEL rated one bank and has been for three or four examination cycles, and you take a bank that's a CAMEL rated three for the past – they're marginal operations – acceptable but marginal – for the past two or three examination cycles, what you have is the trainees and the young guys who are just starting in the business – they will send them to, guess where? The number 1 rated, so they could see how a good, well operated bank runs. They'll learn from that banker and they'll see what it takes, and what good numbers look like. The seasoned ones will go to the troubled banks. That creates an inequity, just by design. All the ones that are smart and know what the hell they're doing – I never get to see them.

You get the dumb kids.

Well, I get the newbies. They're generally bright and intelligent – I get the newbies. And I almost find myself having to train them. What they do – they'll come in, and they'll go, 'I was reading in your board minutes that you did this or that, and I don't really get it,' and I'll go, 'Well, I wouldn't expect you to because this is your first day on the job.' And you talk through it and you can see the light come on. And so when they go to the Number 3, and they either don't see that particular notation in the minutes or they don't see that particular notation in the minutes, they tie it back to previous meetings. Then you get these hot shots that are trying to make themselves a name, and they can be very very difficult. And I have to sit there and take it. In the early days, I'd go, 'You snot nosed little brat,' now I go 'yes sir, no sir,' to a 20 year old because they're my regulator. I don't think that there's purposeful inequity. I think it's the nature of the beast. They've got to train their people just like I've got to train my people. I remember when I came on – when I started on the job – he put me, my first job was loan collections. I went out and I was responsible for taking the worst loans in the bank and collecting on them. The reason he wanted me to do that was because he said, if you can learn what a bad loan looks like, then you'll make good loans from this point forward. Conversely, the Federal Reserve, when they're training their young people and constantly training them – you constantly train them because they make great bankers – so you train them up in the regulatory environment and guess what, they can become compliance in a bank because they learned from the best. So you take your newbies and put them with a new banker – and you learn what it takes to run a good bank, and you can identify what the problems are in a non-so-well-run bank. I think it's by design – I don't think they come in with a chip on their shoulder. I used to think that – I've come full circle – I don't believe that any more. I think they're here to help you. They have a job to do. We have a job to do. We've got to work together.

Relationships – what are your points of contact?

You've got the regulator over here, and the interaction flowing toward us. And you've got the interaction of us flowing towards the regulator, and they look different. Regulators are first of all, they're sending down laws and compliance strategies and guidance. That's generally not verbal – that's written communication that they send to us. And then we have to interpret that and that sort of thing. Quarterly, I will get a regulator on sight, unrelated to an examination, where they're just trying to get a feel for the economics of the community and the state and the region. Give them a feel for what's going on from an economic standpoint. So that's generally the extend of the communication from them flowing down to us. From us flowing up to them: I take the philosophy of out of sight, out of mind. I stay quite. I come in, I do my job. I figure if they don't hear from me – you know what I mean? Now, there are times when I wanted to do things – for example, I did a denovo branch in Stillwater, so I had to seek approval for that. So I'll write them and tell them of my intent to seek a denovo branch application, and we work through the denovo laws and application process, so I'm working with them through that process. So I do speak with them from that standpoint. Sometimes, I will seek interpretations of the law. Sometimes, I will say, you know, I'm getting mixed signals here. My consultants are telling me one thing, but from my years of experience, I'll interpret it a different way. So I'll make a call and I'll say, what is the official interpretation from either the state or the Feds on this particular situation. And I do that from time to time. And I'll log that call. I'll make a note, time of day, I talked to this person. Because if that person comes in for an examination, they're going to stay consistent with that. If somebody else comes in and they interpret it different, they're going to go nope, you did it wrong, and now we'll write you up. And now we have this dynamic of, I called Bob on this day and this was his interpretation, now you on this day are giving me this interpretation. And I was operating under what Bob told me and we have to work through that. Many many times they will say it makes no difference what Bob said, it only matters what we say today, here, on sight.

But the due diligence – best practices ...

Best practices makes all the difference in the world. We have got to be able to show that we are 100 percent on board with trying to comply with the law, that we are not thumbing our nose at anything, and that generally goes a long, long way.

How do you square, out of sight out of mind, with “relationships are valuable” ?

The out of sight, out of mind that I'm talking about is really from a compliance – from a pestering kind of deal. You can see how I could come to work every day and say, I am scared to death to make a move. So let me call the Federal Reserve and say, look, can I take a coffee break? You just pester, and pester, and pester, and – I can see them running around the office, saying, that Exchange Bank in Perry, they're driving me crazy. They won't even do anything without calling me first. From a relationship standpoint, Bob Tolner is the head of the Federal Reserve, Oklahoma City Branch. When I see him at an OSU football game, we sit together, we eat hot dogs together, we drink a beer together, I know how many kids he has. He knows how many kids I have. We're developing a personal relationship. Same with the state banking department. They need to see us as people, as individuals, and not just as a bank number,

registration number on a sheet of paper. I found that to be most beneficial to me, when something comes up – the state commissioner, Mick Thompson – I have a good personal relationship with, I can hear him, and I've witnessed him say, Look, take Exchange Bank Perry, for example, that Chuck Hall has been there for 22 years, third-generation banker, that guy knows what's going on. Wow. That's what you want – your bank commissioner saying. As opposed to, 'There's some banker in Dibble or wherever, and I don't really remember who that is. Guys, go down there, check the place out. Tell me how it's going.' He knows me. He knows that if he has some sort of problem, he can pick up the phone and call.

Has that changed from 15 years ago to now?

Dramatically, because my attitude has changed. I don't hate them. I don't see them as a burden. Actually – and the way I got over it, I'm highly competitive, and most bankers are. Look, we are inundated with peer information. What I do mostly in this office is peer comparison. I have a peer group that I have picked out that are tied to generally my same size, my same size stockholders, my same kind of operations. And I want to be the best damn bank in that peer group. I want to be. I'm highly competitive. So when we have examinations – I want to be the best performing bank in the State of Oklahoma. And I'm going to use every source, every possible way that I can do that. Look, if I play in a football game, the worst thing I want to do is piss off the referees. Don't I want to be their friend? That's a great analogy – I don't want to piss off the referees. Federal Reserve? State banking department? Referees.

It's an advantage. I'm looking for every advantage I can get. Look man, if you're mom's favorite kid, you're less likely to get scolded. If I can be Mick's favorite kid, it makes it a little tougher – if, when he would normally write me down for a violation, they're going to come in and go, man, hold out your hand, don't do that anymore. Yes sir, I got it. As opposed to writing you down and slashing your regulatory rating. I don't know if it makes a difference. But it can't hurt.

Manipulation? Did you ever want to do anything that made you want to change regulation?

Sure. I mean, sure. I mean, sure. Absolutely. I mean, look. I would never dare try to change something was enforced, and again, we go back to the law is the law, is the law, is the law. But what I would do – I would lobby our concerns of the community bank. Look, let's look at this from the 30,000 foot level – and you're going to hear this from every community bank you talk to in the State of Oklahoma – we did not cause the financial collapse. We didn't cause it. We are not the cause of it. New York, big city, East Coast, West Coast. They're the cause of it. They're the derivatives buyers. They're the volatile mortgage holders, the discounted stuff. They did that. So guess what happens – let's create laws that make sure that will never happen again, and we all have to comply with it. Big, small, whatever. We all have to comply with it. So, believe me, at every chance, I'm in front of congress, I'm in front of our state representatives and senators. And I'm going, people, what you read in the Washington Post is going to be different from what you read in the Daily Oklahoman. Completely different. And you all have to understand that community banking is different than the corporate banking stuff in the big cities, and you've got to protect that. You have to protect that.

Let's get more specific – just for you. The Know Your Customer Act. I'm in a town of 5,000 people. I'm the mayor of Perry. I was born and raised here. My family's been here since before statehood. I know every customer that walks into this bank. I know them intimately. I know their kids. Where they graduated from. I know where they live. I know where they go to church. I know everything about them. So when somebody comes in and opens a new account, it's very easy, I know them, or I don't know them. If I don't know them, I get three forms of identification, the name of their first born. Where they graduated college. We've been doing this for decades. But guess what? The Know Your Customer Act now requires that I've got to hire a new compliance person – or buy a new piece of software – that I can prove that I'm running through the Ofax system, that they don't have any outstanding warrants or that they're not funding the Al-Quaida, when I know that Uncle Bob is not funding the Al-Quaida. They don't get it, because you can't make laws that say – but now, they're doing a little bit better. They are starting to break it up by the size of banks. If you're a billion or over, you have this compliance status, if you're under 100 million, you have this compliance ... they're doing a little bit better, but the laws, we have to comply with.

So, in answer to your question, I lobby where I can – at the state level, is where I'm most effective – at the federal level, I have to rely on the ABA to do that for me. Fortunately, Frank Keating is running the American Banker's Association, he's a good Oklahoman. So, we have – he cares a little more about Oklahoma because he used to be a governor here. So I depend on him and his staff to do it at the national level. At the state level – now, here's a little bit of background you didn't ask for: I used to work for the Oklahoma Banker's Association. I was their director of government relations, so I was their head lobbyists. I passed the interstate bank branching act for the state of Oklahoma, and I passed the denovo bank branching act for the state of Oklahoma – the two largest law changes in banking. From that, Mick Thompson, he has to periodically change the state banking code, and he will call on me. And he will say, a, what do you think about this, where's the devils behind the trees, where am I hurting community banks, where am I helping community banks before I run this up there. We talk through it, make sure nobody's getting hurt, it accomplishes what he wants, doesn't hurt community banks, and then he says, will you help me with it. Sure – because he knows I know how to lobby, I'll run it up to the state capital, it's the commissioner's bill, your people back home won't be mad at you, vote yes.

Constraining boundaries – you guys telling on each other?

I can't watch him from a compliance standpoint. I can't watch him from a regulatory compliance stand point directly, because I don't see his examinations. He doesn't see mine. I will see something go on up there – I will hear that this customer go this loan at this rate, and I will go, now, how can they do that? But I stay out of it. We don't stand each other from a compliance standpoint. When we look at our peers, it's 100 percent performance based. You're trying to beat them from performance – and overall return on equity, an overall return on assets, deposit growth, loan growth, etc. If I see an enormous amount of loan growth up there, I don't think – they can't do that unless they're breaking the law. I don't think that.

What I look at is, how did they get that? Is it in their marketing? Is it in their people? Have they done something different? What's their pricing structure? Because I can see all that – that peer

information is public. They've figured something out, and I'm a winner, so I've got to figure out a defense to the pass play, or whatever it is. We don't – even my competitor, who's a block away, versus one of my peers who may be in southeastern Oklahoma – we aren't looking and saying, you can't do that without breaking the law. That's just not something we do. This is a big fraternity. At the end of the day, we're all part of the same team. We're not whistle blowers. It just doesn't happen. Particularly community banking. Maybe BOK or Bank First can be considered a big bank, but even Bank First is the largest state chartered bank in the State of Oklahoma. And they started with one bank in Shawnee. I mean, they get it.

So maybe not amongst yourselves – but what about outsiders?

I think you've got a misinterpretation – look, other bankers may look at it a little different – it's not so much the encroachment that bothers me. It's now they've expanded the congressional intent of what a credit union's supposed to be. First of all, credit unions pay no federal or state income tax. It's a competitive advantage that I don't have – I've got to pay taxes. I have to retain capital and pay taxes all at the same time. I'm the largest shareholder in this bank – but in the sub S, I've got to pay taxes on my retained earnings. So lets say, hypothetically, that my earnings this year is 10 million, I pay out 40 percent in dividends just to cover my 40 percent of the tax I pay to the federal government. 60 percent remains in capital because I have to have capital to grow, so now, I'm paying the government -- \$400,000 in a year – I didn't get the benefit of it. So yes, they have a competitive advantage. It's not so much the encroachment as it is the – when congress, when they set up the credit union system – it made sense to me, we're all about it – small mom and pop farmers pulling their money together so they can all buy a tractor that they can share. I'm all about that. I'm all for it. And what congress said was, that as long as you all have like interests – in this particular case, it was farming – you can pool your money together, and we wouldn't tax you on the income you made on using that tractor. So as the years and years go by – now its farmer John, and his family, can be members of the credit union. Now it's farmer John, his family, and his aunts and uncles. Now farmer John, and his family, and his aunts, uncles, cousins, etc. Now, you look at Tinker Federal Credit Union, what advertisement do they put nationally on the ... anybody can be a member of the credit union. That's not fair. So it's not the encroachment, it's the competitive advantage they have. When you don't have to pay taxes, you can pay more on your CDs and you can get less on your loan rates. That's a competitive advantage that bankers are pissed off about. When it was small mom and pop deals – when it was \$5 million in total assets – that's one thing. But when you get up to \$500 billion in assets, it's a different deal. So it's not that encroachment is the problem – it's the competitive advantage that credit unions have that really, really cut us to the quick.

Any efforts to fight this?

Constantly. Constantly. Here's the problem. The problem is – I bet they don't teach this in college – the problem is that Congress' paychecks are deposited in the Congressional credit union. Federal judges are deposited in the federal judges' credit union. The own state banking department's paychecks go through the state of Oklahoma credit union. Even Mick Thompson's paycheck – goes right in the state credit union. Now if the Federal Reserves paychecks – and their examiners – are being deposited into the credit union, where they're getting high interest rates on CDs, low interest rates on their home loans and car loans, why in the world would they

lobby to change it? You see what I'm saying. We go to the president of the United States himself and say, they have a competitive advantage over us, and he says, you're right, they do, somebody should do something about that, I'd like to write a check for the effort, and he writes it on the congressional credit union checkbook.

Now there may be some types of changes – a collapse in the credit union industry from an operations standpoint, a safety and soundness standpoint – then you might see some pile on, and this tax stuff might change. Another place where this might change would be from the deficit – look, I'd be speculating on the numbers – but I'm telling you, it'd billions of dollars of missed tax collections by the federal government giving these credit unions a free pass. So if we need to help the deficit, that's a way to fend off tax increases – just by taxing those people that aren't being taxed now. That are providing – Oooh, I'm going to sound like a whiny banker – but credit unions do the exact same services that I do. They're no different. I pay taxes. They don't. Why shouldn't they? Somebody should be saying: we've got all this deficit, and the only way we're going to get out of it is to increase taxes or decrease spending, well, why don't we start looking at credit unions, which are doing the same things banks are doing and start taxing them as one aide to help with the deficit.

Interview No. 5

Background?

I came here, actually, in the role of compliance officer, so I was primarily working with consumer regulations when I first came here. That was why I was first hired. But I've been in banking 30 years maybe. I started as a banker. I worked at several – family owned banks – that was interesting. Then, I had an opportunity to go work for the Federal Reserve as a safety and soundness examiner. For the Kansas City Fed, but out of the Oklahoma City office, and did that for about five and a half years. I had some expertise in the risk management function, so I try to keep my hand in it by doing some compliance exams at least once a year. So I did keep up with regulations and where they were going. Then I had this opportunity. Wanted to get off the road, so I came here.

Your role here?

I'm the chief operating officer. In the last few years, I had the opportunity to step up. I was the chief credit officer during difficult times, to help kind of bring us out of that. I was a credit expert with the Fed. So used that expertise, and hired someone in, and took over when we had a lame duck CEO, last year, and served as chief operating officer during that time. And now we have a new CEO, and I'm very happy.

Nationally chartered bank. Switching over?

I'd be interested to know what other people's arguments are. To me, if you do business – I'm speaking for myself now, not for the bank – but if you do your job right and run a good bank, it's immaterial who the regulator is. Different regulators have different points of emphasis, but all of my years of experience on both sides of the desk – but it's clearly dictated by Washington. It's

very political in nature, at least what the points of emphasis are. Your underlying premise should be protecting the assets of the depositors. It's very interesting to me – the whole concept that the public has – the whole perception that the public has is very interesting – because they view banks as a public utility, when in fact, they are owned by people who deserve to earn a return on their investment, whether its public or closely held. So because of all of that, and I think people sometimes – to me, I think it's very clear. You're regulated because we hold insurance. We hold insurance by the FDIC – and I also have another, I guess, belief – that most of the regulations we have today are because somebody, somewhere did something wrong. And the government, in the way that it sometimes does, overreacts, and we paint everybody with the same brush so everybody gets to abide by the same rules. Except for credit unions. They don't have to pay taxes, they don't have to follow community reinvestment act. There are so many things that make it very very interesting, especially as they demand more abilities that make them look more and more like a commercial bank. To me, it's very interesting.

As an examiner, you've got to maintain that objectivity. And I know when I was an examiner, I did not bank at a bank, because you don't want to have to ever be in a position where you're examining a bank where you're a customer. So you have to be careful about that. As far as – it is probably cheaper to be a state charter bank – so that is one aspect. However, it's not so much a factor today, but it has been a compelling reason in the past, if you're going to be in more than one state, you had some federal exemption – you could just follow the Federal laws, you didn't have to follow each separate state. So if you were a multi-state bank, it was important to me, anyway, that you a Federally chartered bank.

And that's the other thing to me – now you would find varying beliefs, even within our own management team – but my personal opinion is – the Federal Reserve regulates the holding company and the OCC is our primary federal regulator for the bank. To me, that's very simple and it's clean cut. I get the same thing everytime. Every exam is the same. However, if you're a state charter, depending on the size of your bank, you either have a joint exam with the state banking commission and either the FDIC or the Fed, depending on if you're a Fed member or not. The way I had seen it as a banker on that side – as a state supervised bank – there was a discrepancy from one year to the next, one exam to the next, depending on who was leading it. There's a difference in the quality of the supervision at various agencies. The Fed takes great pride – I don't think you can get a job there unless you had a 3.75. So it's – they take great pride in that – I've seen, however, when you come to the state banking departments – and this is just a general statement across the board – certainly not about Oklahoma – as a general rule, they don't pay as well, so you did not get the highest level.

Mick Thompson, yea or nay?

I think part of that's different people's personalities and perspectives. I don't like to have to rely on politics. I'd rather do a good job. I don't want to have to rely on politics to get what I need. And I don't like to play politics, and people who kind of get off on that like that environment. I would prefer not to have that environment. I just want to do things right.

What is your regulatory supervision?

The Federal Reserve is the umbrella regulator for all holding companies. Any bank that has a holding company is also regulated by the Federal Reserve. The FDIC would come only if you're a state chartered bank who does not have Fed membership. So all state chartered banks can be regulated by either the Fed or the FDIC, and it depends on whether you hold Federal Reserve stock. And again, that gets political – so you get upset at how the Fed regulates you so you change to the FDIC. And I know that – there were some laws passed where you couldn't change regulator when you were in a certain position, so it tried to keep banks that were in a poor position from changing and blaming it on the regulation. Don't blame it on the regulators.

Characterize the relationships across agencies?

My perception is that any regulator is willing to work with the bank. I think part of it is how the bank responds to regulation. I have worked places where it was very adversarial with the regulators. The bank did not want – they saw them as the enemy. I've seen places where – I've probably examined places – where it was clear that the employees had been told to not tell the examiners anything. To me, that's not the way – they're just people doing their job. They are not the ones making the laws and the regulations. They are just doing their jobs. So I think it depends on how you interact. I have, for example, I am the primary regulatory contact for our institutions, and I make sure that if something is happening, especially since we're public, I don't want our regulators to read it first in a press release or a news release. I want to reach out to them. And likewise, when they see something coming down the pike, they call me and say, hey, just a heads up. I think it's nurturing a relationship, so it's not one sided. It shouldn't be one sided.

We are regulated from the OKC field office, so we have one person who is over us, and we have an examiner who is assigned to us and only oversees us, and it's usually for a cycle, three to four years, whatever is determined internally. So you do get some continuity that way. And I'm sure they have rules on how long they can be so they don't get too familiar and compromise their objectivity.

Who interacts? How does the interaction work?

The OCC, for our size, they do a quarterly review – only on sight once, maybe twice a year. They do a review of our call report data, anything we submit. They will sometimes do questionnaires. They do come in about six months after our examination to follow up on any issues there may have been, to see how we're doing. And they are in here because of the size of our institution. They're in here once a year, and are here for about four weeks. They send us a letter requesting the information they want to review, sometime before the exam, we'll have it prepared for them. They will review the information, they'll interact with – if its reviewing loans, they'll talk to the credit people, if it's capital lending, they'll talk to the treasurer and his department. And the way the OCC currently does it – we're not big enough to have continual supervision, where you have someone here all the time – but they do monitor our staff through our reports. If they saw something that raised a red flag, they would probably call. But I try to make them never have to call. I try to give them a heads up if something is anomalous. What's going on over there? Of course, like any regulated institution, we get ratings, based on the CAMELs rating, for our basic rating structure – capital asset quality, management, earnings, liquidity, and sensitivity to market risk. An then a composite rating. They also rate our IT,

because that's a very large risk area. And they, if you have a trust department, they'll rate your trust. They'll rate your compliance. And then, not every year, but whatever the time frame is, they'll rate your CRA, and that's your only rating that's public. Community reinvestment act. That's the only rating that's public.

Proactive? How do you maintain relationships on your side?

I have the ability, I email them. I pick up the phone and call them. We have a new EIC, examiner in charge right now, so just building that relationship, this will be the first exam he does for us this year. But to me, if you treat people with respect just like they're a guest in their home. They're just here doing their job. I've never had issues with anybody. Even the bank has certain challenges. To me, it's all about attitude.

You get what you give?

Right.

Do you see faces, or do you see faceless agencies?

Absolutely. Of course, I have a little bit different perspective because I've worked with the people at the Fed. I actually know all of them personally, they were my colleagues, or my boss, as the case may be. And I will say this – I don't want to get ahead of what you want to know – the OCC, one of the things I appreciate about their supervision is that they're very systems oriented. They look at what your structure is, what are your systems, what are your controls. Rather than nit picky details. The FDIC, who currently regulates our sister bank in Kansas, is very transaction and very detailed oriented and very much no sense of materiality whatsoever. The same emphasis is put on something that is an absolute non event as is what is a huge issue. So to me, that negates the effectiveness of supervision when they throw out this huge plate of issues, and some of them are just like, 'Really?' It just is – I don't appreciate that kind of supervision. To me that's not helpful. I'd rather somebody say, hey, we see holes in your structure.

Do the agencies help or are they an obstacle?

If your bank – if a bank – is in sound financial condition and they have confidence in the management, then there's not a hindrance. Now, the agencies themselves, that would be the answer. Regulations, laws, they can be a hindrance. There are many banks – let me give you an example – we choose not to do home equity loans in Texas. The reason we don't to home equity loans in Texas is because of the incredibly difficult compliance with their Texas laws related to home equity loans. So instead of learning that and managing that, we've chosen not to do that, which limits our opportunity and limits our customers' access. So, to me – but that's not the regulators – all the agencies are doing is enforcing the laws or ensuring the banks are operating in a safe or sound manager.

Your services/products are constrained ...

By the regulations themselves. Absolutely. Another example would be the higher price mortgage loans, where you can't have more than a certain spread. It actually impacts our profitability, so we don't fall into that category where we have to do all these disclosures, we just squeeze our margin down so that it doesn't fall in there. I mean, that's ridiculous, when you think about it.

What percent of performance is influenced by the regulatory environment?

I can't quote you any numbers or percentages because I actually haven't done that study, but that would be a really interesting study to do and we probably should do it. I have a very good compliance department. Because of the people that I have, I probably have, I don't have to have as many people as other organizations of the same size. But it's significant. The amount of dollars we expend on training, education, the staff themselves, and now, with Dodd-Frank, it's just exploding, and you know, when I start budgeting for next year, I'm going to have to think about that.

What about opportunity cost?

At some point, we'll probably address that. Quite frankly, that's part of the nature of what we're doing there. Except in Stillwater, we're not really a retail bank. So that's not been a huge issue for us, but we have a new CEO, who's probably going to want to expand in some of these markets, so we're probably going to have to start looking at that. But no, that's very astute – we really haven't put pen to paper. We're cognizant that there's a lost opportunity cost.

The rule book. How do you know what's in the rule book?

My compliance – the person who manages my compliance department is responsible for monitoring new laws and regulations. How we internally manage those is different depending on the impact of that law or regulation. If it's a high risk, it's going to be treated differently. If it affects more than one department, it's going to be treated differently. So we may convene a task force if it's going to be something that impacts various, across departmental lines. If it's something that is just one department is going to have to deal with, then we might handle that differently, then we might provide some guidance for that department manager. Help them – give them – feedback, when they develop procedures to handle it. And I have, since I've been either the compliance officer or at least the compliance department reports to me – so over it in some sort of manner – I think my philosophy does permeate a little bit – and I do not believe in compliance as an add on. To me, that's impossible to ask your front line lender to understand everything. Now, there are some certain aspects – they need to know fair lending, they need to be sure they aren't discriminating – they need to know certain parameters. But to know all this stuff, they can't possibly do it. So my philosophy is you design procedures and policies and parameters and processes that, if followed, ensure compliance. Because that's the only way. Everybody can't be an expert. So my compliance department is the expert.

How would you create a procedure or process based on a new rule?

The FACT Act, when it came out. The identity theft rules – that impacted so many of the departments in this organization, from the credit area to the mortgage people to operations, I

mean, to IT, that we convened a task force in that case. Somebody representing every one of the areas that was going to be impacted – I bet we started anywhere from six months to a year before the implementation – and tried to review all the ramifications, see, you know, figure out how we're going to do this and develop some type of software to be able – to allow you to do that, which we did in this case. Almost every new regulation that comes down nowadays includes a risk assessment ...

What's a risk assessment?

They require you, as part of it, to do a risk assessment. So, for us, that's much bigger than the bank at Laverne, or some of the smaller banks I've worked in. Because you really have to think through all the ramifications of all the things that you do. If you're really going to do a true risk assessment. So it's not just – so you've got to figure out what's impacted, then you've got to figure out how you're going to deal with it, then you've got to write your procedures. Then almost always, you have to figure out reporting mechanisms and control mechanisms on the back end. It's always complicated. One we're going through right now is the mortgage rules. The changes in the mortgages rules – that doesn't just impact our mortgages department, but we do mortgages in house as well, so it impacts our other lenders and our credit department as well.

Are the rules easy to understand? How much uncertainty is there with a new rule?

There can be. I think probably, having worked in smaller banks, in my life, too, they – again, I hate to throw out generalities, but I think this is probably generally true – in small banks, they usually do not have the expertise or the sophistication to handle that. And they're heavily reliant on outside assistance. The OBA does a superb job of providing support for those kinds of institutions. There are vendors – BKD, the accounting firm – has a compliance practice, which I actually worked for for a while. They actually provide this service for smaller banks. And I always saw that as a niche that somebody could – I want to say exploit, but that has such a negative connotation –

We're not Marxists here ...

To me, that was always something, because how could somebody afford me on their staff at a Laverne? And I had a lot of that size of banks who were my clients, when I worked for BKD, because I could do for them what they could not do. I could review the regs, I could say, let's look at your processes, whether this is going to impact you. It wasn't nearly as complicated or complex as it is at an organization this size. Here, there is still ambiguity. One of the things that we do that a smaller bank can't do is try to look at the proposed regulations and comment. So, that does give banks the opportunity to say, OK, this is really unclear so what standard are we going to be held to? What are you going to be looking for? And sometimes they will clarify that, and sometimes they don't. But at least you can try to provide some feedback on what is workable, what isn't, what is unclear, what isn't. There is always, even if it's clear, in the world of regulation, you are still subject to individuals who are doing the job. So is there a difference between the people who examine you? Absolutely? My job, my philosophy, has always been, is that my job is to know more than the regulator, and that has served me well. If we know it better

than they do, they're just like, every other company now – they're stretched and their resources are thin – and I will just tell you, just an ancillary statement – I detest getting green examiners.

We've had our problems. It's public – we were in a formal agreement for credit issues, I think 2011 – so we've had our problems.

The hot shot kids go to the exemplar banks ...

Now, we have had after last year, after we cleaned up and did a \$350 million bulk sale and took a \$100 million loss, which thankfully, we had the capital to do, we did have them come in and bring a training crew in. Now, that doesn't bother me, if they just come in and want to use our files for training. But it's just like hiring an auditing firm, you're getting their June hires in to do an audit. They have not benchmarks, no sense of materiality, no experience to fall back on. And to me, the lack of – I mean, I just used to, when I was a senior examiner, I had younger examiners who worked under me – they would go off on this tangent, that at the end of the day, didn't really matter. And I felt it was my job to kind of pull us back to – OK, lets step back and go across the road and take a look at this from the longer view. Does this really matter? The other thing you get from green examiners is because they don't – they have that lack of experience and because they're always incented to want to shine – you know, they're wanting to find something or whatever the issue is. I always used to think that if they didn't do their job if they didn't find something. So I don't know that – it probably did used to be that way, and I think with the fluctuations with the economy, I think that some of those things have happened, where all they see are bad things they have to get jaded and cynical. I think that's probably true. But we also used to have a saying when I was on the examiners side, that a good economy hid bad bankers. It really is true. It's a balance. It's a balance.

How have you gotten better at knowing what the rules are?

There was a time, many, many years ago when this bank probably had the attitude of – there was a time, at least I've been told, this would have been way before me – that this bank did have the attitude that regulators are our enemy. Let's hide everything. Let's not tell them everything. I think this bank probably did have some compliance challenges from time to time, and I know the guy who hired me to come in here. He was a lawyer. He was the first compliance officer ever hired here, so I think it was probably one of those things that was parceled out. And of course, this bank grew very quickly, and sometimes infrastructure struggles to keep up when you grow that quickly. But I think we have an exemplary compliance department today and I think it's because we hired the right people. I hire experienced people and then we've supplemented that with bringing in people and training them.

Do you hire former regulators?

I'm the only former regulator we've ever hired. That is something we would certainly look at. I have hired former regulators in other areas of the bank.

Although, I will say, it's just like anything, you have to find that balance of academic viewpoint and a practical viewpoint. And I think that's been an advantage for because I've seen both sides,

as a banker, and then as a regulator, and then as a banker. I think it made me a better regulator, and now, having been a regulator, makes me an even better banker.

Day-to-day – how relevant is regulation? Especially related to new products / services, growth, etc.

Compliance is an integral part of everything we do, and I don't know if that's because it's our culture now. I imagine we're a little bit different from some other banks. Our compliance officer sits on our risk management committee. Our compliance officer, the manager of our compliance department, sits in on any new product development. She has to be involved, and she sits on our data processing committee, so she hears any new innovations because anything you do, it's nice to have somebody who has that hat on who can say, OK, all you innovators and marketing types, OK, that's all well and good, but what are you going to do about this law? So we try to bring that balance. Any change or change control process, she's one of the components of that.

Do you ever feel like your decision options are constrained?

I think that's probably empirically correct. Although, I will tell you that since I am not a creative person, I'm probably not the right person to ask that because I see everything through my eyes of this is what a bank is, this is what a bank can do. So, just to be fair ... I'm saying, if its my decision, I'm probably going to always default to, is that something we can do? Whereas, somebody who's much more creative is probably going to try to push the boundaries and then my job is not to say 'No,' – this is also Priscilla's philosophy that I've tried to incorporate here – my job is not to say 'No,' my job is to say, 'How can we do this within the parameters?' So that's our philosophy here; doesn't always mean we can do it, but that's our first go to. No is not allowed to be our first go-to.

Has 'no' been ... ?

I think there are banks where their compliance officers are definitely, 'No, no we're not going to do that.' But my philosophy and what we've implemented with our department is, that's not allowed. Now, it might have to end up being the answer, but I would rather say, well, we can't do that but we could do it this way.

What's the difference between the compliance officer where 'no' is the first option versus the one who looks for solutions?

As far as their perception, the bank is huge. The person who says No is not a partner in the organization, they're viewed as an adversary, they're viewed as somebody nobody wants to talk to. Kind of – literally, in the basement with the auditors – which is actually where our compliance and audit department are. We do live off electric light – sometimes air conditioning.

What about personal characteristics? Like experience?

I think that's absolutely fair. I think your more experienced people have that more depth of knowledge that they can think around the implications and ramifications. I know of one

organization here in the state that's actually a very large organization that one of the people in their compliance department – he is very much a 'No' kind of person – and I know some of the lenders and they hate him. I mean, so to me, that's not – I would rather them be able to pick up the phone to my compliance officer and say, help me figure out how to do this.

You probably have some idea of what a regulatory environment should be. How aware are you of other banks' interests?

I know of banks that my perception is that they could care less what the regulation say – you can see it in their advertising: they don't follow the rules in their advertising. You can see – customers will always tell you that some other bank will do it when you won't – so whether that's true or not, who knows. But yeah, you do have a perception of those that are lax.

I think that the strategic plan of the bank – their ultimate goals – their philosophy – will greatly impact how they feel about regulation. I want to make sure that whatever our strategic plan is, whether its to grow, to expand, to acquire – you know, if you are not in good standing on certain aspects, for example, community reinvestment act, there's a chance you will not get approved for some of those activities. So its, to me, managing regulation, managing compliance with regulation, is a balance act – you cannot, in my opinion, Priscilla speaking not for the bank – afford to try to get a 1 rating on compliance. I don't think you can possibly throw enough resources at it to get a 1 rating. A small bank can do it much easier than a bank this size. But if I were to spend the money it would take to be a 1, it would be astronomical. It would really be astronomical. The expense would be astronomical. So, do we ever want to break a law or not follow regulation? Absolutely not. But to ensure that that doesn't ever happen is cost prohibitive, it's just not possible.

How do you pick and choose? It's materiality isn't it?

It is material. We're not going to do anything – if it's illegal, we won't do it. That's not the point. And I'm not speaking necessarily to – do we make decisions to skirt this law? No, we don't do that. But I'm talking about the systems we would have to put in place to ensure compliance. We have a good control system – that's not what I'm saying at all – but for however many locations we have in three states, because we manage compliance for our sister bank as well, it would just be impossible.

Now, do I want to be known as a good compliance shop? Absolutely.

That's the positive feedback you get with the regulators? If you're a tinfoil hat person ... Anyway, what about the personal relationship? Is that of huge value to you?

It's certainly not a social relationship. It is a more professional relationship. Do I have the ability to call them and visit with them and go to their offices when I want to talk to them? Yes, I can do all that. But am I going to call and say, let's go meet at the bar? No. The OCC in particular is much more careful about any apparent conflict of interest. I know it used to be – years ago, probably in the 80s, early 90s when things were still recovering from the 80s, I used to take the examiners to lunch at the country club just because I knew they couldn't pay. And it would drive

them bananas. And it did. And so they would try to guess what the meal cost, and hand me cash for their meal because they have so much more strict parameters as far as conflict of interest issues.

The Fed is pretty – I think all the Federal regulators, the FDIC, the Fed, and the OCC are very careful about ethics, conflicts of interests. The state agencies are much less careful.

They emphasize the relationship – the personal relationship – you can have the hot dog with the Federal Reserve guy at an OSU football game. The relationship seems critical – you want to have a bond with these people – but I wonder: would you say, that it's the relationship with these people that's most critical?

I want them to respect me and respect my bank. I don't need to be their best friend. I want them to know that I'm a good banker. That I run a good shop. That I do things right. That's my goal. I want them to know that I'm in it to maximize my return to my shareholders and do things in a safe and sound manner. I don't care about going out with them. Now, have I gone and had a drink with a regulator? I have.

Quantify the interactions.

Its different for different aspects. If you're talking about compliance with regulations piece, then its ... we get a question, you know – it's never easy, it's never black and white, there's always some nuance to a question that some case that a lender has and can I do X,Y,Z, and you're thinking, wow, I don't know. And we will try to find the answer first, because we don't like to ask question we don't think we know the answers to. But then, if its something we think may bite us if we don't follow through, then we'll always call and say, hey, can you help us. We have that kind of relationship we can do that and I don't feel like they're going to hold it against us and come in and look for that to be wrong the next time, so I don't have an issue with that. Now, if it's on the safety and soundness side – last year, we paid off our TARP, and I made sure that everything that I did with the regulators – that we were going to do – that they were informed. That they – I always want them to at least think they have the ability to opine. Its because I want to say – OK, what I'm saying to them in better words is: this is your chance to tell me if you've got an issue with this because here's the direction I'm going, and I have it in a much more congenial, give-and-take kind of manner, and I know where I'm going and I want them to know it and give them a chance to provide me some feedback.

Do you keep records of these contacts?

I have in the past, but I don't know. There have been times in my past when, especially when it came to compliance issues, you did write down examiner John Doe told me on such a such a date X,Y,Z, and part of that was this discrepancy between examiners. There is that sometimes. But I think that I'm looking at it from a little bit different perspective. I'm older. I've been in banking in Oklahoma for a lot of years, and I think my number 1 criteria for my departments is to have credibility. And I want them to know when I tell them something that it is the truth. You know, if you establish this kind of relationship, you don't have to worry about all this other stuff.

Move the boundary? Do you ever encounter a regulation that is a hindrance and you'll try, in some way, to change it?

The comment period is one way we try to do that. But are we as proactive as I would like to be? No.

Do you want to be proactive?

Yes. I think as we mature as an organization, as we get past some of the problems we've had over the past few years, as we continue to refine our infrastructure, I think those are some things we probably need to be a little more proactive. Now, I will say that our CEO actually sits on the ABA government relations board. So he does have more insight and more impact sitting on that board as far as the ABA being a lobbyist for bank interests. So that's one way that we do that. I think that in the past, I have probably have been involved at the state level with the OBA in certain things. ABA has a fairly sophisticated comment system for grassroots efforts, and if you sign up, you try to get ahold of your bankers to do that and things like that. The bank industry, in my opinion, as a whole, does a poor job at lobbying. I think we're probably better than we used to be, and I think actually Frank Keating at the help of the ABA – I think he's doing a great job. But I think that's something that, as a whole industry, we need to improve on. We just get so busy doing our jobs.

Any example?

No. Not the OBA on behalf of our bank. We've probably participated in larger efforts that the entire banking community has been involved in. Anything that impacts us directly, no. Not to my knowledge. I think that's an interesting concept – and it really would be interesting to see how far you could go with it – but part of the problem with it being so politically motivated. For example, the consumer financial protection agency or bureau or whatever its called – I mean, it's going to be a pain in every banker's neck. And it's not because bankers don't want to treat consumers properly. It's that some people didn't get treated properly, and everybody's guilty. Or the mortgage brokers in the latest go around didn't treat people properly. So the bankers on Main Street who didn't treat people that way still get to comply with the same laws. It will be expensive. One of the things that have gone away as part of the Durbin Interchange Fees bill, for example, many banks have gone away from free checking accounts because they made their money on interchange fees on their ATM transactions and debit card transactions, and with those capped, now, and I think Congress does a very poor job about thinking about the dominoes following. I think they do not look at the consequences of some of the things they do, and if the bankers could do a better job because it's all, to me, at least in the recent past, grandstanding about, well, I've got to get elected so I'm going to tell these people who bought a home they couldn't afford, somebody apparently coerced them to do that, and now, somebody's going to come and take care of them.

In the last few years, anyway, the popularity of banks has been down there with ...

Are you ever worried about – regulatory blowback?

Yeah, I'm actually not worried about that. We fill out an evaluation after every exam, and I don't mind telling them what I think. Now, I think you have to be careful. Again, a generality: I think a lot of times, the bankers who are the most vocal about – they had a bad examination, it's because they're not doing it very well. I think – I'm not saying we're perfect, we're not, we're people. We make mistakes. But I think if you're trying to run a good shop, I think – I'm not afraid to tell people, you know, you have a loan review examiner who is missing the mark and beating our people up. I don't mind saying that, and I try to do it in a professional manner, and so – it changes because I'm angry about the outcome of what they found; I try to keep it factual. I think a lot of times – I read a statistic recently that I still find – I have a hard time getting my mind around it – that women make decisions faster than men on emotion, which I would never have believed, and I don't know about the validity of the study I read. But I thought, I don't know if that's so wrong, because a lot of the bankers I have run against – banking is a male dominated industry – they're very emotional. It's very personal to them. Whereas, to me, this is facts. We're doing our job. We want to serve our customers. We want a healthy return to our shareholders, and that's my job, and these people are doing their job.

Frame?

We have a culture where the – I don't know if its been that way always – but it certainly is now, but the regulators are doing their job. And we encourage people to answer questions honestly. We try to make sure that people who don't know the whole story don't answer the questions because they can skew the regulator's perception. I will say this: for a lot of regulators, if they start going down – and not so much the OCC, but the FDIC is particularly bad about this – if they start going down the wrong path, it's very hard to drag them back and say, wait a minute, wait a minute, you've got the wrong perception. Because of that, I do try to control the flow of information through people who actually know what they're talking about. But they have access to anybody if they need it. I also try to encourage them – for the same reason – not to hide anything. But I do try to encourage them to try to say, if they're asked the time, to tell them the time, and don't tell them how the clock is made. I think sometimes people can get overzealous in wanting to be helpful and cooperative, and they say things where they don't have the whole picture. Then, all of the sudden, you've got an examiner sitting in your office saying, "What the heck is going on." And then you to go back to square one and explain it.

What are the differences between a bank where it is antagonistic and one that's not?

I think – I'm speaking from my former regulator years – I can remember when you walked into a bank – we had a bank one time, it was pouring with rain on the Monday morning when we got there. It was going to be a big exam. We had probably 15 examiners – maybe not quite that many – they made us stand in the rain, even though they knew us, they made us stand in the rain to check our IDs before they would let us in the door. OK, that does not start a relationship off that well. There was one lady who, in that same exam, she told us a lot of interesting things, then all of the sudden, she was on vacation after that. And does that – so all that does, for an examiner, is raise their antennae with, 'What's going on that we haven't found yet?' It makes them dig deeper, it makes them be cynical. It makes them question everything. I would rather us – to me, the main difference – if you come from a position of credibility and you know what you're doing and you're honest about your faults – I mean, I want to know, if we've got a problem, I want to

have found it before the regulators come, and if we haven't fixed it, I want to have a plan. So, to me, it's all about – I think you make your life just so much more difficult if you have an antagonistic – and you make the regulators view you differently.

Where do you think that comes from?

It's an ego thing, on some people's part. Different answers for different people. I'm sure. A lot of it is this – I've actually said this to an examiner, to a young examiner – he was in haranguing the president of the bank about some thing – and I pulled him out and said, 'He's been banking longer than you've been alive. Even if you're right, you address him with respect.' And I think that's part of it: sometimes personality types – you get egos on both sides. And instead of let's have a congenial conversation, let's talk about the facts without getting emotion involved. But you do have these guys – this is their family's bank; this is what they've done all their life. And I've worked for these banks – they're not in it for the return. They're not in it for the return, they're not in it for a financial gain. It's a warm and fuzzy that they get. They like to be the guy in the community, you know, going down to the local diner and everybody knows you. So I think all of those kinds of things factor into it. But to me, if you have an adversarial relationship, it just makes your life so much more difficult.

Boundary contraction?

I think it does happen occasionally, but I don't think it – the guy who used to work here, the guy who worked here was a lawyer – one of the banks here in the state was giving away a free car for something – I can't remember how it went – but it was a lottery, which is against Oklahoma law, and it violated some other advertising laws and things like that. He actually did write a letter to the state attorney general. And he said, in the interests in competitive pressures, my understanding of the law is 'this' – now, he's a lawyer – so if I'm misinterpreting this, I want my bank to do the same thing. He wasn't saying – it was interesting how he did it – he wasn't tattling on this guy – he was saying, were at a competitive disadvantage if we aren't allowed to do this, so tell me if I'm missing something. And before long, all of the sudden, those ads were dropped.

Credit unions ...

I think bankers – I don't know why we're bad at this. I know the ABA will come out every once in a while – or the OBA – and everybody will get all excited about it. And all of the bank presidents from Oklahoma will go to Washington. But as far as a concerted in-the-front-of-the-mind regulation – I think everybody in the bank is so focused on serving customers and making sales, doing deals, that that's what's in the forefront of bankers' minds instead of 'If we don't wake up we're going to turn around and credit unions are going to have exactly the same opportunities, exactly the same benefits, except they don't have to pay taxes and they don't have to comply with the community reinvestment act. I think it's all very interesting, and then what will happen. Because what will happen – because they don't know how to do these commercial loans – there's going to be a catastrophe, some sort of economic melt down, just like in the 80s with the thrifts. The thrifts, what they were doing, they were making these very low interest rate mortgages on very long terms, they had huge interest rate risk, and it bit them. They didn't know

how to manage that. And nobody even knew how to regulate it – I mean, the regulators are learning, too. But I think you're going to see the same kind of catastrophe – it's just like a bank growing too fast without infrastructure. If you don't put infrastructure in place, and if that happens, to me, it's just you're asking for trouble at some point. And we'll get the brunt of the regulation that comes down after that, and they don't have to comply with half the regulations we do, and they don't have to pay taxes, which completely changes their profile.

Seems like if you back a dog in the corner ...

Well, what you're seeing is a lot of family owned banks are closing or selling. I think you're going to see a lot more bank consolidation because of the, I think – I mean, I hear rumors that people are actually going to give up their FDIC insurance. Now, I don't know if that's feasible, if people will put money in their bank if they're money isn't insured.

I think people do try, but its – I don't know if it's because bankers don't want to band together because we're inherently competitive. I don't know what the deal is. I don't have a good answer for it.

Interview No. 6

I have been in banking for 35 years. I have an accounting degree as well, and I'm a CPA. But I've never practiced. I've always been in banking. I was at Union Bank for 22 years until it was bought out. Then I went to Local Oklahoma bank, then it was bought out. I worked there six years, and I've been here seven. I'm president and CEO here.

Have you always been a state bank?

No, we were a national bank and we changed about eight or nine years ago to a state, Fed member charter. We have the Federal Reserve and the state banking commission, which alternate examinations.

That happened before you got here. Why switch?

It was not due to overregulation or anything, but as a national bank, the capital requirements – and it wasn't really the capital requirements, it was the amount of – the lending limits. They're stricter with a national bank than they are with the state banks. You can do larger loans as a state bank, and that was one of the deciding factors, and also, the fees are less. So you have a lot of state chartered banks in Oklahoma.

We had a really good relationship with the OCC. That was not one of the contributing factors here at all – it was just simply that we wanted to do a little bit larger loans to get our loan volumes up.

Regulatory environment? Relationships?

Excellent, with both of them. I'm on the community bank council for the Federal Reserve in Kansas City, and we have real good report.

Are there differences in how the state does their job and how the Fed does theirs?

Any agency, you're going to find differences. But they basically use the same guide lines and everything. The way they come in and do the examinations, they both do them differently, but you sometimes have that within an agency: depending on – if you have the Federal Reserve has called people in from other states, other districts, to work on exams, and having people from locations of the country makes a difference in your exam and in the way they look at things. So if you have someone who's coming from an area where they're seeing a lot of bank failures and everything, they have a whole different attitude than a regulator who's only worked in the 10th district.

Is there a difference between the FDIC and the Federal Reserve:

Well, you know, we've not had a Fed examination – I'm also on the council for the FDIC – the community bank council in Washington. So I think the – from what I've seen, they're really trying. Chairman Gruenberg is really trying to reach out: he sees the importance of community banks to their communities and to the banking system as a whole. I truly believe that. So I think some of the things that have been going on in the past, he's truly trying to make the focus more of an overall risk to the system rather than being real picky about different things. But you know, you have different offices around the country, and they're going to have differing issues. If you've been a regulator in Georgia and you've had all those bank failures because they started too many denovo banks in Georgia, then you're getting ragged on because you didn't see that coming. You're life is not going well if you're a regulator in Georgia. Hey, why didn't you see that you had too many banks? Why didn't you see that? So regulators get a bad rap because bad things happen. So the pendulum swings way, way, way too far to the right, and then they're looking at everything, and making issues out of things that maybe they didn't in the past because they're being so criticized. I'm not justifying it, but that's what happens. It's done this twice: I was in the 80s in Oklahoma, and then I saw the last recession. So I've been through two major recessions in my banking career.

Mortgages – another great example – what happens is the pendulum swings so far to the left, you basically had to pass a breath test – if you're alive, you're going to get a mortgage. That's not right, those standards should never go that loose. And then people get them and can't handle them and they default, and we have repercussions from that, and then the pendulum goes all the way over here, and very qualified people are struggling to get mortgages these days. It always happens, that's just the way it is.

Do you handle interactions?

I handle them, but Janet Plouff is our cashier, she handles a lot of questions on operations. And then, Priscilla Qune, who's our CFO, she handles investment type questions. In fact, it's ironic, next week, we're meeting with our representative with the Federal Reserve. We have periodic meetings where we just go to lunch and chat about how things are going. We send emails back

and forth to each other. If there's something – and not necessarily something bad or good – if there's just something different in our reporting, you know, the banks have to file quarterly call reports on the financial condition of the bank, and if there's a number that's a little bit out of range. As an example, we got a very huge deposit the last day of the year. There was nothing I could do other than tell them that our numbers were going to look skewed at the end of the year – because it's new year's eve, there just isn't anything I could do with that money. So anyway, I just sent them an email and said, look, the call numbers are going to look a little strange, we had a huge deposit, it's going to work its way out, but I just wanted to let you know about it.

There are, I've found, I believe that there's more, in my opinion, more positive interaction and communication between regulators and bankers than there previously has been. Because when my folks got in banking, they wanted to stick the regulators in the coldest, darkest, dampest room to get them in there and out. And I don't think people have that – some bankers still do – but my theory has always been, get them the information, and get them in here, and give them everything they need to get their job and get out.

How would you characterize your relationship with the agencies? Do they help or hurt?

Well, both. But, the way the system works is, Congress makes the mandates and then its their responsibility to interpret the law and make it into the regulations that we have to abide by. And so, I mean, when you have the size of the law passed like Dodd-Frank, I mean, that is a hurdle. That's a hurdle for them and it's a hurdle for us. So, there was not – I mean, there was some parts of that that may end up being good, but for the most part, that was very onerous regulation on banks. Very bad, in my opinion.

What proportion of your performance is influenced by the reg environment?

You know, that's really hard to identify. It's really difficult to do that. We spend a lot of time and a lot of money going to classes, training our people. How many hours? It's really hard to tell how many hours you spend specifically on compliance. Here at our bank, we have 37FTEs, we all do compliance. We all do it. We don't have a compliance officer that that's all they do. So it's really hard for us to document that. Another thing that's come into play – it's very interesting – the advancement of technology. There's this – kind of – crossing of the technology and the compliance requirements because we've been able to save on personnel because of technology, but at the same time, we've had to move responsibilities for compliance to those employees so we still have basically the same employees, but because of technology, they're doing less banking, and because of regulation, they're contributing more of their time to that.

We spend a lot of time – every day, we have to do things – you know, when we open a new account, we have to do things because of regulation that we wouldn't have done in the past, like getting all this information filled out so we know who the customer is. So every process that we have has been burdened with regulation. Every process we have in the bank.

What about opportunity cost? Are there things that you'd be doing ...

You know, if we didn't have to do a lot of the – as an example: one of the things that we've been toying with is doing online account opening. And for a bank this size, that can be helpful for us, although we don't need deposits or anything, but we've been thinking about – that we need to do that just to keep up with the technology and what our customers want. But, on the second hand, you have all these regulatory burdens on identifying the customer. So, you know, you have to make sure – you have to do all this inquiry and you have to use a third party service to validate that that person is who they say they are. And so, it becomes one of those things where the cost and the benefit – you know, it's really more cost than it is benefit at this point in time because of the regulatory burden of just identifying who the customer is.

Things you've quit doing due to regulation?

Student loans. We stopped doing student loans because the regulatory burden is so onerous, and that is just wrong. It should be that students could come in here and get a student loan, it should not be the process. In my opinion, the government has made a huge mess of the student loan business. The average student comes out of college with \$30,000 in student debt. Average. That means a lot of people are coming out with tons more, and a lot of students are coming out with none. So \$30,000 – that's a horrible burden to be putting on the youth of our country. When they're starting out. And you have a lot of people who are going to be going into professions that don't have high incomes to repay that. And here's a perfect example of a product that, you know – one of the things that bothers me the most about regulatory oversight is instead of going to the agencies that were poorly managing student loan business, and saying, stop. You're doing a poor job at this, we're going to do something to cease you from doing these things. They just make rules that everyone has to abide by, and that's wrong. That's my biggest criticism of the regulators.

Was that a significant ...

It was a good book of business for us. It wasn't huge, but it was a good book of business. And the government kept getting more and more and more and more involved, and they kept taking that business away from us, and then all of the sudden, they made the regulatory burdens so onerous that we couldn't do it.

How do you know what's in the rule book?

The law has been passed, but the rules are far from being written. And once they take a portion of that, and write the rule – OK, Basel III, on capital regulation, is 995 pages. That's the rule. Well, it was stipulated in the law – it was part of that – how many thousands of pages of legislation, and now the rule interpreting that law is 900 and something – so we have thousands of pages ...

All these classes. We depend on third parties to help us. We depend on them. The OBA, the ABA, usually, when these rules come out, they immediately analyze them and put out a summary. Now, there was a summary put out with the new Basel III capital requirements, but it's been misinterpreted. That's why we're having lunch with our Federal Reserve contact to see exactly – from a regulators standpoint – how that's going to impact our bank. Because our

independent auditor sent out a summary, and then our broker sent out a summary, and those two summaries looked like totally different laws, and they're analyzing the same law. But it looked like they had been written from two different laws. You have to be careful – you have to squint through all of this stuff and really dig into it and find out. I haven't read 995 pages of regulation ...

There's nobody here reading the rule books ...

No. And you won't find it – even in the big banks, most people don't do that. They may have attorneys on the staff that will do that.

So the OBA and the ABA ...

And there's tons of consultants.

And classes and consultants. What else?

We read all the time. We go to the meetings. Now, the Federal Reserve, one of the things that they do that I think is really good is that they have – I think they are semi annual meetings – and they bring in all the presidents and upper management of the bank in to a meeting and they say, OK, here's what we're seeing when we're out doing the exams. We're seeing these as problem areas in banks, or we're seeing banks not doing this properly, or this is coming up, you need to do this, you need to start working on this. And those are very, very, very helpful. So that's a positive thing the regulators do. And you know, that's a positive thing the regulators do. And for the most part, they do try to help the banks. Another thing that they've done – and this came out of one of the meetings that I went to – the community banker depository council meeting – we were talking about this, and someone said, why don't you put a guide, like if this regulation, if this only applies to banks \$10 billion and over, put that up in the upper right hand corner so we don't have to read it, because you're reading it all the time. If it doesn't apply to me – just put it in that stack.

Ambiguity? Is it always clear?

No. I just said – these two agencies – two different experts had a totally different interpretation of the same rule?

Sometimes, you know, they try – there is a council – that when there is a regulation that needs to apply to all FFIEC – they try to issue a rule from all of the regulators. So, as an example, a lot of the rules for computer security, client/customer security – those come from the FFIEC, which is the agency that they use when it's a – I would say, it's when all of the different agencies need to issue one regulation, they do it through the FFIEC.

How do you cut through the ambiguity?

It is difficult. We rely a lot on third parties.

Difference between the written rule and how the rule is enforced?

Here again, you get back to human interpretation. So, another example of that is: what the American Bankers' Association has recently done is they formed an anonymous pool for bankers to anonymously report any areas that they felt they were harshly judged on in an examination. It's national. And what we've found were there were certain offices throughout the country that were focusing on one point and so we took it to the regulators, and said, look, the Dallas office is really, really being overly aggressive on their interpretation of fair lending. And here are all your other field offices, and here's the Dallas office. 9 out of 10 exams are getting this as a written violation. And that's – that's not the numbers, I'm just giving you a hypothetical – but only two out of 10 in these other offices, so, you know, FDIC, you might want to look at this office. So, it helps to point out the differences in the different regions, and because, you know, different offices – it's just, you know, natural that you're going to have different hot points. And we're so energy driven here. Well, a regulator in New York, they're not going to look at those loans the same way or have the same knowledge. Agriculture's so big in the Midwest, and commodities.

How have you gotten better at staying on top of the rules?

It's gotten harder, because there are so many more rules. But I think the agencies, associations, and every – the organizations that you belong to – have gotten better at getting in there and trying to provide information. Technology's helped a lot, because there are all kinds of webinars that you can attend, so its easier to get quality information than it used to be. It used to be you have to spend all day at a class or read it your self or hire an attorney. So I would say that technology has helped tremendously.

Software you use?

Technology does help a lot. How hard it is for the vendors to keep up with all of this. So it's really difficult and they're constantly having to update and implement the software and a couple of times the regulators have had to delay the enactment of some of the regulations because the vendors or people simply could not get everything done in time.

But some of the stuff they require, you know, it's really challenging for the software companies to keep up with all the regulations.

Day-to-day: how relevant are regs?

Everything we do. Because they just changed all the appraisal regulations, they changed all the mortgage lending regulations. And like the student loans, someone comes over from the university and says they want a student loan, and we say, we can't help you with that any more. Car loans. Fair lending has become a really big issue. You cannot – it used to, if we had a customer who had large balances with us and they wanted a car loan, we could give them a better rate and we'd justify it because they had large deposits with us. Now, the regulators want everyone to have the same opportunity – it doesn't matter how good of a customer, it doesn't matter if they've never opened an account with us. If they were to ask for a car loan, we'd have to give them the same rate we'd give the other person. It's really causing – it's more difficult for

us to manage a business – it’s a business decision, and it’s not intended to discriminate against that person, but that’s how the interpretation and law is being enforced.

Decision options limited?

Absolutely. They’re very limited. As an example: overdrafts. I will tell you that there are people who manage money by just writing the check and they’ll figure it out later. You’re not going to change that person. I don’t care how much Washington things that that person is being abused – it is a choice that they made. We are actually helping that person by paying their check and not returning it. If we returned that check, they have the opportunity to get into a lot of trouble. Plus, its going to cost them money, its going to cost them money at the store, but you cannot get people to understand in Washington that people – that not everyone manages their checkbook like they should, and that’s how they manage their money – through overdrafts. It’s a convenience, it’s a product. And they’re willing to pay for it – they’re not the ones griping about it. It’s the consumer advocates in Washington that are griping about it. It’s not the people using it.

How do you know when change occurs?

They do post the dates and everything, so you have to keep up with that. The regulators give you dates and timelines, and the ABA and the OBA do a good job of keeping you forewarned about when those implementation dates are going to come out.

How aware of other players’ interests are?

I have a good idea. We have meetings all the time. (Through the OBA). I’m on a couple of ABA committees, where we meet. We have roundtable discussions on how it’s going to impact you. All kinds of things.

Are there differences between the bankers?

The less you have, the easier it is to run the bank. That’s pretty much a shared vision by all bankers. That we have way too much regulation.

I would dare say that every banker would say they’re over regulated. I would be appauld if you could find a banker – I would be shocked if you found a banker who thought it was not an overregulated industry.

What types of interactions do you have?

We have good interactions. I have no qualms with the regulators – I just have a problem with the regulations you have to enforce. I have no problem with the regulators.

Proactive. Extremely proactive. Meetings. In face meetings. If you don’t understand something, you get down there and talk to them. I write letters – they ask for – they put something out for comment periods, I always write comment letters. I call congressmen. I talk to them about

legislation before its passed. I go to Washington and meet with congressmen. I am very proactive. Very proactive.

Sometimes, there are times when I spend maybe three days (in Washington) doing very proactive lobbying. It's lobbying on behalf of the banking industry. The comment letters. I'm also a CPA, and I also engage the Oklahoma Society of CPA's banking committee and being very proactive and writing letters on behalf of the financial sector if a legislative issues does not look like it's good for banking. I have that group write letters as well.

Personal relationships ... ?

I know all the people at the Fed. I know the people at the state. I know people at the FDIC. I mean, next month, I'm meeting with Chairman Gruenberg. I'm really active in that.

Do you see faces or nameless agencies?

I dare say that if there's anything that needs to be address, I have people I can personally pick up the phone and talk to?

Are some interactions more interactive? Give and take?

They're all pretty receptive. Now, whether they take my suggestions or not is another issue, but they're very open to at least hearing my opinion. By the way, all letters are public. If you write a comment letter, it's public. I had a reporter from the Wall Street Journal call me because he read my comment letter and asked me questions about my letter, so you never know where it leads.

How have you been able to improve – you're the most active person I've talked to – have you always been that way?

I would say there's two ways to look at regulation. Are you going to just sit down and take it or are you going to try to shape it. Because you're going to have regulation. But my position is that they need to understand how that's going to impact my bank, and they don't know that, so it's my responsibility to tell them. And I frequently do.

I'm much better than I used to be because I have just seen so much bad regulation come down that I feel like every banker ought to be as active – and bankers were not traditionally proactive, politically. Not traditionally. All banking – there were, Basel III, there were thousands of comment letters. Thousands of them on Basel III. They're getting tired. They're saying, look, stop. No! No, we're not going to take it anymore. We're not going to let you sit there and ink all this stuff that adversely affects us.

What do you to get rid of a constraint?

A lot of them, if they've been enacted, there isn't a lot you can do other than, I continually – if there's just really onerous regulation, I talk a lot to the regulators when I go to these meetings – HMDA – it's very, very onerous timewise. So I tell them, HMDA, HMDA – you're giving us

information, it's very difficult, it's not black and white how you report it, and we need some relief on how this is done. So as a result of that – I was in a meeting – and so the regulators came and met with 10 banks from Oklahoma at the Federal Reserve to do just a Q&A to fill out HMDAs. Cause I told them, we have these cases that come up that don't fit black and white, they're grey, so we report them this way, and on examiner comes in and says, that's how you need to report them. Then the next wave of examiners come in and say, no, no, no. And I say we did everything the first wave of examiners said. So I said, come on down, I want to show you what we struggle with, and so we gave them three cases, which they had to take back and get resolved with some of their higher up examiners to figure out how we should report those. But we got that in writing, of that's how we report it. So those are the things that I, as a bank president here, manage. Because we were having a problem. Every time someone new came in. I said, look, we want to abide by the rules, but let's make the rules the same. So how are we going to do that? How are we going to affect that for this bank. So they said, OK, we'll send someone down, we're going to do this. And so we're going to – we have an agreement with that regulator as to how they're going to look at our HMDA. And it's not that we're doing anything wrong. We were abiding by the law as we saw it, that every examiner that came in was looking at it differently, because it was a grey area. That's the problem. Rules are not black and white, they're grey. And that's when you get into the problems.

Sounds like its easier to change how the rule is enforced ...

No. Its easier to change the rule before it ever gets finalized. You have got in there first. Because – let me tell you, once these things come down, they are written in concrete. Once the rules come down. You can say, Oooh. This is a burden, this is a burden. And you're not going to impact. Before it happens. That's why bankers have become so proactive.

Look, this isn't going to help because – and they have a tendency to, when something's bad happened in the banking industry – that's when you get more regulation. And at the very time when the industry is at a critical point at helping with the recovery in a recession, you're burdened with regulation. So that actually hampers the lending and the recovery of the economy.

Have there been bills that have come up that you've been able to stamp down?

There have been rules on a national level that we've been able to stamp down. I'll tell you, there were some changes made in the Basel III. And that's something you could read about, there's a lot of information out there right now about how it was changed because of all of the letters that were written. So there was change affected in that regulation. There have been a few victories, but not many.

Does a lot of activity happen at the state level? Are there reps ...

Yes. They usually run those through us. How's this going to impact the banking industry. Not that they're trying to write laws for us, but they're kind enough – and I think that most of our legislators do that for each industry. They're not trying to hamper an industry in Oklahoma by writing laws. Now, every once in a while, we'll get a law that someone feels they were personally abused by some method that someone used or something, and it's an individual and

they'll go tell their legislator, and they'll do some law that maybe is not very smart or – you can see where it came from, but it's not going to be good law. And so we have lobbyists out there that read all the new legislation that stay out there while the state's in session to try and keep something like that from happening.

Then the commissioner has his own bill ...

He does, and we work with him on that. In fact, the attorney for the OBA submits language that would be acceptable by the bankers for the commissioner's bill, and they frequently accept what we send in. They'll send over what their thoughts are, and it's negotiated. He is one of the better state commissioners. He really is. Other states – I mean they've got some jokers out there, so we're really, really good. Having good relationships. And he does a good job – that's why you have so many state member banks. He understands that if you overregulate this industry that it doesn't help the industry. He gets it. And if he sees something that's just an onerous, ridiculous rule, he helps fight it. I mean, he's helped us on several different issues. Now, that's always the case. There's some things we disagree on, but if there's something that just looks like it's going to be onerous to the banks and not benefit the overall banking industry, he's right there with us in the ditches.

When you seek a rule change – are you reacting to a specific customer request?

Well, you know, if you – well, like student loans. I can't help students now. It's a choice we made but it was because it was overburdensome with the regulations. We don't do that many here at a community bank to go through all the training and mark all the compliance issues and everything to do the student loans. And the government's basically taken that industry over. And I personally think they have made a real mess out of it. So that's an example. It's just that we can't do things for our customers – our customers in general, not individuals.

On certain – I don't know that they're asking permission. They're just trying to see if a unique situation fits within the guidelines. Again, it's one of those grey areas. We frequently recall on individual examples of grey areas to see if the regulators are going to come in and say it's a violation, you shouldn't have done it. It's best to call first. It's part of being proactive. And they're real good: both the Fed and the state about being getting an answer. Each bank has a person that is their liaison with that agency, so you can call those people, and we do that frequently.

Are banks supportive of each other when they're facing a rule/reg problem?

Sure. Oh yeah. Now, that being said, there is a major divide between the ABA and the independent community bankers' association (ICBA). The ICBA was for Dodd-Frank, they said we're going to get regulation, so we might as well try to shape it how we can. The ABA said absolutely not, we're going to fight this to the death. I personally believe the ABA was right, and I dropped my membership in the ICBA because of their advocacy of Dodd-Frank. I thought it was totally off base. As an industry, we could have fought it. We were only one or two votes away, but the people who were on the fence in congress – they go, well one agency wants it and one doesn't, so I've got free reign.

Brown Vitter ...

You know, what's a big bank? What's a small bank? I will say that the repeal of Glass Steagal gave the big banks a lot more opportunities for other income than community banks have. I personally think that was the tipping point in banking. And I think what was added to the system at that particular time was risk, and so I believe that – as I don't have a number in mind – but I do believe that the large banks generally have been operating with like four percent capital. They won't allow community banks with that, and the thought process is well, these big banks are so diverse, they have so many different industries, well, you have a major recession, everything goes down. So I do believe that they need to have equal or more capital because of the risk. I mean, that's just dumb. But anyway, I'm – it was interesting – to me, that may have been the most (outside Dodd-Frank) interesting legislation.

The comprehensive income is an issue from an accounting standpoint. The average person who looks at a financial statement does not understand comprehensive income. They do not understand that those are just book losses or gains. So where do you divide the line. Are the financial statements for only astute investors, or are the financial statements for everyone to read?

How about boundary retraction?

Not so much banker against banker as banker against others. And I'll tell you a classic example right now: and I'm very proactive on this because it's not good, it's not good for the systems. Payments. (Credit unions – we'll take them, too – they need to be taxed.) But the payment systems like Jack Dorsey and Square and all these other companies that want to come in and provide good technology – and I understand that. Consumers want that, but consumers don't understand that when they have a paypal account with money in it, that it's not FDIC insured because the banking industry has done such an outstanding job providing a secure payment system. But you have all these ancillary payment providers that are not regulated or insured. And it will happen – one of these new startups is going to blow up and lose money and everybody's going to go: Federal Reserve, where were you? You were supposed to be regulating all these people. So you have all these non regulated players who are trying to come into my space. And I have all these regulation burdens, and it makes my model so expensive. And that's the same problem I have with credit unions – my model is more expensive. They're doing the same thing, but I have the more expensive business model.

There are a lot of startups that are going out to get venture capital to do these same type of payment systems, and one of them will fail or one of them will have a significant breach. We have all these regulations on our security, but they don't – they have no regulation. It's going to happen.

What about the fiat currencies that are out there? The bitcoins? It's a fiat currency, and they are regulating that. I believe that there are people who are manipulating the market on that. Because if you watch that, it goes up and it goes way down, and I believe that there are people who are –

because there are no regulations that can stop that from happening – I bet there are a lot of people who are making a lot of money on that.

What's your frame?

I think it would be bitter about it. I'm bitter about it. I think its too much. There's too much – the government has put so many regulations like, for, we have to monitor for money laundering – do you know we have 37 FTEs? Here's a regulatory burden: we have one person that looks through our transactions of all of our customers all day long to figure out if we have anyone money laundering in our bank. Now that's offensive. That's her full time job. There is something wrong when you have, out of 37 people – we may do a better job of it than other banks. But it's still an example of how – now, you can go down to this CVS store and buy 100 dollar gift cards off the rack and pay cash for them all day long, and no one's ever going to ask you anything. Because you're a nice looking, clean cut, young man. No one's ever going to ask you a think about it. But you come here, and I have to ask you your birth day, your address, and your ID.

It's not – they put the burden on us because they can. There are mules that go around all day long buying gift cards to launder money. And they're not – you know – it just goes undetected. We have to dedicate a full time person to review all of our transactions to make sure that people aren't going over the limits that's set. That's a burden. That's a true burden.

And we have computer software that gives us the reports that looks at all the transactions – but we still have to do that. We have to report that to the government.

Interview No. 7

It's a maze. It's like the mouse is over here and the cheese is way out over here somewhere. And the maze changes. It's like you're a little kid with a crayon and the crayon's been broken multiple times.

They keep changing things so much. For example, it is the National Mortgage – like right here, we have a – this is our Intranet. So we go to the Web site. The NMLS resource center – it's just like an acronym everywhere – well now, because of the Dodd-Frank Act, they call it the NMLS-R number. It was fine just being a four letter word. Why did they have to go and mess with it and throw in the R? You didn't need another letter. We still communicated what it was all about. So if you're a brand new person that's not been involved in compliance before, it turns out that we have more and more students each year that go to compliance school. So what compliance school is – this is – the OBA is a wonderful, wonderful resource. I'm sure you've found that out in talking to Janice Reeser. They're awesome. This would be a binder you would get if you were a student. It's hosted by the OBA. Most of your states have a state banking association – somewhere along the way, they will provide a compliance school.

And generally, it's going to be around a week long. For example, here's the faculty, and the board. And this is the list of your attendees, so you can get an idea – what's cool – kind of scary – is they, each year, you're going to get a median age of how many males and females. What do

see there? A bunch of folks have been in compliance a year or less. They're like, oh, my gosh, and it's kind of humerous. As a board member, we can sit and watch these people – and see, here's the little acronym thing – and what needs to be added this year. They're smoking crack and adding things that we need to keep up with.

Reg O: have you heard of that one before? Enron? Sound familiar? Golden parachute. Insider training. There are different controls and different things put in place, and reg O belongs to insiders and regulators.

My federal reserve booklet looks like this – it looks like I've died on it (it's so marked up) ... The Dodd-Frank Act is now called the Fraud-Dank act. It's a complete fraud. The sad thing is that the community banks like mine and like Jane's ... we didn't screw all this up. We didn't pull the wool over consumer's eyes. We didn't say sign here, wink, wink, and watch your mortgage go through the roof. So now, banks our size – I have eight locations, all in Oklahoma – about \$530 million assets. We're not a ginormous bank, regulated by the FDIC – we're not all over the country. I know my customers. I see them at Wal-Mart, you see them at the ball games. You see them at church. They're going to hunt me down and find me if I rake them over the coals. And it's not like the ginormous bank, where they're just an account number. So fortunately, the folks that did all this crazy regulatory stuff – was a total knee jerk reaction to the sub prime stuff. We didn't engage in the sub prime stuff. We're not in a bubble in California or Atlanta or Chicago or these different places where they had insane increases in their property values.

Well, in the 80s, Oklahoma learned what not to do. And so we said, we'll pass on this one and that one. We're going to live and watch these other fools and that didn't learn from us.

Oklahoma may be different ... ?

Very different. The oil thing happened. We're like, this is – we're watching this stuff melt down around us. We had very few banks fail. What's ironic – those of us who've signed up for email alerts for the FDIC – Friday afternoon at 4:30 – look at who failed today. You'll see, usually, one bank acquire another bank. It's usually the smaller banks – either (rural) or some of those others areas I mentioned – like Atlanta or Chicago – that got hit with the subprime stuff. But some of these regulations that they've overreacted and thinking: these consumers have just been so affected by the predatory practices. For example, reg z – this is the regulation, this is the commentary. The big joke was that the commentary is longer than the regulation. What does that tell you? It's complicated. It's confusing. And if you print out the disclosures, the customer's going to be like: honey, this makes no sense. Will you read this? And he's like, I don't know what it means. So a lot of this stuff has been confusing. Customers like, they don't know what it means, just tell me what my house payment's going to be, and how do I close the loan, and what do I need to bring to closing? That's all I want to know. So that's – all this stuff is consumer friendly kind of stuff, and we get all of that. This is the first thing you learn in compliance school.

Banks are required to make sure nobody is laundering money through your bank – it's fun. Everybody does – banks have to have an employee that watches to make sure that folks aren't laundering money. You don't have terrorist activity going on in your bank.

The thing is – the fear that we have of not doing it right – and the crazy thing is, the BSA regulations, they're not even banking regulations. It's pure law enforcement. So we have to do it. Car dealerships have to do it. Everybody has to do it. It's a group of law enforcement regulations. There are specific parameters you have to follow that are specific to banks – like if you sell a cashier's check, you do a wire transfer, you have to document certain information a person's identity when they open an account with you. You have to have procedures and policies. And in fact, the exam manual that the regulators use when they come to make sure I'm in compliance looks like this – it's 443 pages long. This is the world of banking. Isn't it awesome? It's just like, we have nothing better to do. My staff is 3 people – my self, an assistant compliance officer, and I have one person that does HMDA. Full time. It is because – you know, we're so afraid that if we get it wrong, there will be penalties. Why HMDA is so important is – it is the basis for the fair lending exams. And they're so important, and HMDA data – we can't discriminate against race, gender, ethnicity, religious beliefs, anything. You've got the fair housing act. You've got the fair lending. Fair lending is involved with everything. Cause if a customer walks through the bank and says, walks up to the receptionist and says, I've gone bankrupt about 10 years ago and I want to apply for a loan but I don't think my credit's going to be OK, and she says, Oh, honey, I wouldn't even bother, I've impacted a customer but it's not the receptionist's job because she's not trained to look at credit because she has no idea how long that information is going to show up on the customer's credit report. That's not her job. You can't discourage loan applications. That's specifically in the regulations. That's a fair lending violation.

So our job is to make sure that everybody in the bank knows about fair lending. You can't discourage loan applications – everybody who walks through the door and expresses interest in applying for a loan – come on down! I'm Bob Barker on the Price is Right – fill them out, fill them out, fill them out. Get them to the right person and let them make the right decision.

If you have customer contact – in fact, for this month, it happens to be fair lending training, and we actually have a session for the operations side of the employees, and then the lending. Lenders will get it deeper, obviously, because they deal with different parameters. Fair credit reporting act. When we pull a credit bureau and we deny a person based on that report, there's additional information and disclosures that go along with that. That's a huge thing.

We've never had a flood in Oklahoma, have we? Think about Hurricane Katrina. Here's an interesting statistic. If a person in one house in a block in a street of houses has a fire, generally how many houses are going to be affected? For sure that one house, maybe the houses on either side of it. If there's a flood, how many houses are going to be affected? Think in recent news – so you've got all the stuff – they call it Frankenstorm – crazy, that was horrible – it wasn't just one tiny area, it was a big area. It affects FEMA, it affects you and I. Because everything that costs you more, it costs all of us more. Lumber – it skyrockets nationwide. Not just in that little area.

So Katrina was a devastating effect. All these hurricanes in the gulf, and along the eastern shoreline. What happens is if you decide you want to go purchase a home and get a loan at the bank, you have to do what is called a flood determination. We're going to make sure – and we

have to pay a vendor to go look and make sure – that’s where all the costs of all these things come from – we have to make sure that the property isn’t in a flood zone. And they say, if it’s in a flood zone, you’re good to go, but you have to have flood insurance before you close the loan. So the customer has to go get hazard insurance to pay for the fire, get hits by lightening, or gets hit by a tornado. If it’s in the flood zone, it has to have flood insurance. So if the customer, along the way, decides not to pay flood insurance anymore, the bank’s now make sure the customer goes and gets their flood insurance. We monitor and track it and make sure they have flood insurance, or we get dinged by the regulators. Because FEMA’s like, we can’t afford to pay these people to rebuild their homes because they don’t want to get their flood insurance.

Kind of like the BSA stuff – they’re using us as law enforcement. I never got deputized. I never got paid for it. But I’ve got to help find the bad guys. Flush them out of the system. I have to turn them in. I have to file a suspicious activity report, and a suspicious transaction report.

It’s been there for a while, but the continued emphasis – you do it, you do it, you do it – and the flood thing has gotten worse and worse and worse because it seems like the natural disasters have gotten – they come in threes or sixes or something. So it gets shoved down to these newbies (in the classroom).

What’s your background?

I did the traditional role of I’m going to be a teller, and I was going to go to school and pay for a journalism degree. You know what – now, I couldn’t do it – they’re on crack, writing their stories. Get your opinion out. ...

Take for example, if you’re a student, and you might be doing an internship and being paid, you would not normally be paid in cash – a check, direct deposit, electronically – if I start see you making \$9,000 cash deposits every other day – you’re going to have to cut me in on your deal. Landscapers are high on the list – frequently they have undocumented employees. Frequently – like almost always. I heard one report that landscaping and hospitality are number one and two for a certain demographic of employees.

You know, some of this stuff is kind of stereotype stuff – but sometimes, it just is what it is. And we see other activities, and we’re like, come on people. And then see publically traded companies – and I’m like, the country club, and the house on the beach in Florida – and you’re watching and reporting, and you’re like, this can’t be right. And then you see the stuff in the paper, and you’re like, crap, we were right. Dang it, there goes a loan, cause the dude’s got a loan with us. You just wish you weren’t right sometimes ...

There’s a lot of responsibility for the smaller community banks because we don’t have a staff – everybody in our bank would be the size of their compliance departments.

So back to you?

The bank says, you know, we’ll pay for finance classes. And that was easy – I’m changing my major. I became a supervisor – and finished my associates. Then I thought, I can’t be doing this

full time and going to school. So I finished my associate's degree, and worked my way through different departments. And then I got done with that, so I went to Southwestern Bank, and moved to accounting, then loan administration. The beautiful thing about working in the smaller bank and a branch environment – you get exposed to everything. I've been exposed to the tellers side, the accounts side, loan administration, loan operations, accounting, moved into internal audit. Got my CRCM – which, it's the certified regulatory compliance manager – it's very highly coveted for a compliance professional – it's almost like the CPA for the compliance world.

Usually most job posting you see for compliance folks, if you don't have it, they expect you to get it within the year. Many of your regulators will have it now, too. So I've had several of my FDIC folks go, hey, tell me about this. I've even volunteered to proctor the exam for folks who can't make it to the national testing dates. So they'll either have those at the ABA compliance conference or some of the national schools that they'll have. Got involved with the OBA and the ABA and have been on the compliance board for I don't know how many years now – I've been the chairman of the board; I've also been involved in the ABA's annual compliance conference. It's a compliance conference – we had almost 1600 people this year. So instead of your students, it's expected to be an advanced level of compliance. We've got vendors. Consultants. Every regulator – CFPB, the OCC, the FDIC, the Federal Reserve.

That's some of the big stink about the regulatory stuff – if the regulators were doing their jobs, they should have seen this stuff. Hey, this doesn't look right. And then, you have the whole 'too big to fail' issue – wait a minute, that doesn't seem right.

I went to graduate banking school at SMU – a very good program – exhausting. Very good, though. And I teach sessions at the OBA – I moderate the case study. And I spoke at the ABA conference.

Have you always been a state bank?

At one time, we were a national bank. OCC regulated. However, the cool thing about being a state, non member bank, being regulated by the FDIC – you have a higher legal lending limit. Which means we have a commercial customer, who wants a big, high-dollar loan, we can do it by ourselves without having to give part of that loan out.

Were there regulatory reasons to switch over?

Not really. Each regulator has a little bit of a personality or a flavor. Is that politically correct? Some banks despise the FDIC, and I'm just going to tell you, if you look at any enforcement action statistics, the FDIC's up there. But they regulate the most banks. The smaller community banks. They have most of them. The big banks, Chase, Bank of America, OCC regulated. They have bigger banks but fewer of them. The OCC has an office in Chase, they have an office in CitiBank, they're there all the time. That'd freak me out if I went down the hallway, and there's my regulator – I'm not talking to you. But I have no problem picking up the phone and calling my regulator at the state or national office. Even Washington. They do not have the best reputation for dealing with specific issues. Each regulatory agency has the country divided into different regions. They've got the Dallas Region, the San Francisco Region ... Dallas Region for

some reason has had a weird thing about some of the discriminatory issues. They'll go off on a tangent – this is a hot button! – and we'll go, no, we haven't heard that from Washington. They're really big on fair lending. We're all just a bunch of bigots – and up here, what's the deal? Well, hell, why aren't Florida and ... it's just Oklahoma and Texas? That doesn't seem right. So there's a disconnect sometimes at the ABA – a small group of us visited with Mark Pierce – he's the guy who's over the department of consumer something, and he's a little beady eyed guy – I don't like him. And he thought he was going to pick information from us ... hey, how are you all doing? He's the new guy. New kid on the block. Scary smart, Harvard educated. And this is what I don't like about the Consumer Financial Protection Bureau: if you know anything about them, a big portion of their staff is department of justice attorneys. You don't show up to an exam with a fleet of attorneys with you. They show up with all their bad guys, going, hey, we're here to find what's wrong. You just started off on the wrong foot. This Mark Pierce guy, and this is not derogatory – he's a little kind of short guy, two big black guys with him – they're all examiners. I was like, are these your body guards? What do you think's going to happen here? We just finished lunch, and he's thinking this is going to be a real friendly. It was bloody. I'm surprised he got out alive. People were getting angry because they were getting written up for things that apparently people inside the FDIC knew about – but the banks didn't know about. In the past, there had been this information sharing thing, hey, we've changed the exam procedures – they're on the Internet, so you can go look at them – you know we'll be looking for this when we get there at your next exam. And all of the sudden, stuff hasn't been updated in years. What's the deal? So if you had an error ratio allowance on your HMDA or five percent, and suddenly, it got lowered to 3 or 2 percent in their little internal stuff that we didn't know about, you're just getting smacked stilly in the exam. We're like, hey, you aren't going to tell us this? And he would dance around the answers and he's going to pull information from us, and he's just getting beamed left and right – I got written up for this, I got written up for that – arrgghhh! – and he's just like, time out. And suddenly, who turned the tables, and when did this become, 'trust me, I'm here to help you,' but it's like, 'we're here to get you.' When did this change?

And the whole regulatory environment about eight nine ten years ago – all of the examiners were – they'd show up on sight to do an exam, and they'd look and look and look until they found something. And then, they'd recognize that that was just inefficient and a waste of everybody's time. They'd pull out 50 to 100 files and just dig through them. What's the point? You know there's going to be something wrong in there. Some kind of technical violation or something. So they moved toward what's called a CMS – compliance management system – and they looked to make sure did you have appropriate policies, procedures, monitoring, training. Those were relevant. They could rate you on each of those. And now, nobody's come out loud and said, OK, we've moved away from that. But the whole consensus is that everyone – ok, you've got all these massive regulations from the CFPB, and what happened was – let me show you something – this will make some of this make a little more sense. This will be the CFPB's Web site. One of my favorites. Although they're not the primary federal regulator, I'm regulated by the FDIC and the state banking department – now that they, beginning July 2012, they took over from the Federal Reserve, 14 consumer protection regulations. But that's the biggest chunk of what most banks deal with on the consumer protection side.

REG O, why would the not rename it? We've got two Reg Os. The Federal Reserve used to write everything, so the bankers would be familiar with the language, the commentary, the guidance. Everything was pretty consistent. I knew what to expect. If proposed regulation would come out, you've had like 20 days, and you'd have another year to comply. It's not that way now because what happened, when the CFPB was born or hatched or landed from outer space. There's not a lot of love toward the average banker to this bureau. Notice, it's a four letter word? There's some questionable letters in there we could do bad things with, but I won't say that. They've made our lives absolutely miserable. And for no good reason. It's costed – it's adding to the bottom line, and what the average consumer doesn't understand – it's going to translate to more costs for every product that they will need from the bank. And that's not what they presented themselves to do. They say, we're the cop on the beat. No you're not. You're creating potential cases for DOJ attorneys to come litigate. That's not going to help anybody. But what's happened, a lot of folks thought, what a cool thing to be on the ground floor of a new agency. So folks from different agencies – they're heavily recruiting – hey come join us. What a cool thing. Train wreck. I know several people who did that – one guy in particular left the OCC, was pretty high up, let's go see what they've got going on over there. It's disaster in there. They have about 3 weeks of regulatory training. All of that. You can imagine the crash course – they recruit smart people – maybe booksmart people. But they didn't have the banking experience. And they didn't have an understanding of how the whole process works. They don't quite know how everything flows. And they apply things in a different method, and they might skip the heart and the intent of the regulation in the first place. I'm programmed to go 'heart and intent,' you can't just pull things out of a regulation. It has to apply to a specific area. You can't misapply something. It has to apply to something – it's got to all flow. So somebody comes and pulls one thing out of context, and I'll go, did you miss the whole conversation about why this is what this is?

I've heard horror stories from other CFPB examined banks, and they'll get a three week notice and a list of hundreds of items – I have at least a month, and my list won't be nearly that long. There's just not a reason to be that way. You have to be a banker financial institution of \$10 billion or over to be regulated by the CFBP. Arvest is a bank in Oklahoma regulated by the CFPB.

How do you know what's in the rule book?

Oh my gosh. Let me give you a good example. Just yesterday alone, I probably said bad words yesterday. We got two emails yesterday – this is one of them, this is the other – so that one was at 2:07, and that one's at 4:47. Really? 4:47. They pulled this crap the Wednesday before Thanksgiving. This is bizarre. So before they took control of all these things, the Federal Reserve would proposal a rule – here's the comment period, when it ends, then you'd go, this is messed up, and I think you should change all of this. Of course, the ABA represents us very well. And so, they do comments at the ABA. They have form letters, and you can use those to submit those. We've written comment letters as well. The Fed would take into consideration logical comments. These people (the CFPB) don't get it. We can't decide if it's a conspiracy, they don't want to get it, they don't care, they want to get rid of small banks? I'm becoming a conspiracy theorist. We think they want to get rid of all the small banks to have only a handful of small national banks because it's easier to regulate. Basel III, hmmm, how's that working for them over there? Not so well.

Think of the cost. Think of the manpower. Think about it. Cause if they're just trying to overwhelm with these regulations, we've heard more and more banks – are just walking away. They can't do it. If they don't have the staff. These are thousands of pages. 5,818 pages for the CFPB. It's doubled since then. That's the scary part – most of it hasn't been written yet. The thing from the bureau: we think the customers should be more educated and allowed to shop. Ok? Customers are going to go shop for car prices. They're going to look at the cars, look at the sticker. But the average customer is going to stick with their bank. This stuff was buried in another section – I've got to go look for this stuff.

There's no oversight. Here, have a blank check. Every other regulatory agency has a panel of oversight. Not them. They have jurisdiction of all banks over \$10 billion. They can share information about their institutions with other agencies – it's kind of creepy. Even though they're not my direct regulator, if they become aware of a product that I have that they feel may somehow have a negative impact on consumers, they have the right to come onsite and say, let me look at your stuff. Then, I'd be calling my counsel.

They have the reach because they now own the interpretation regulations. There's nothing that can stop them. The 16 regulatory divisions for consumer protection has been moved to them (the CFPB). The bureau keeps issuing what they call, these little – small entity compliance guides – some of it is helpful, some of it just makes you angry. When they send crap like this out – here's an example: they try to make all this stuff be helpful. This was issued yesterday – they did this back in April, there was no sense in me trying to digest all this stuff plus one, all that stuff in there, but wait, back in July of last year I had the previous regulation. It doesn't ever end. Nobody can keep their head above water.

So how do you do it? It sounds like you've gone a little crazy?

I don't drink yet, but I'm thinking about it. I eat a lot of chocolate.

Cost of hours to implement. It's unknown – because all the titles have not been implemented.

Are you not offering products or services?

We've not come to that point yet. Now, actually, we're at the point of not offering balloon mortgages. Here is a dynamic that most small community banks deal with. A lot of your customers simply cannot qualify for a traditional, 30-year, fixed-rate mortgage. So they will go to their community bank, they may be self employed, they may not have the documentation required to get a secondary loan. I've known the customer. I've banked him for 25 years. He makes good money. He's already paid his car loans as agreed. I'm going to make him a house loan – I just can't do the fixed rate, and I can't do the matched funding. Because of my interest rate risk, I can't lock him in at a rate. I can get him a five year, with a balloon at the end. I'm going to renew that balloon, refinance him, and do that over and over and over. But he can't get the loan anywhere else. So I'm needing – there's like a niche market there for those customers, but the CFBP thinks of those loans as predatory. So you tell me, I've got to tell that customer, I'm sorry, that's a predatory loan, I can't do it. He's willing to pay the higher interest rate. He

can't get the loan in the secondary market. I need to offset my risk because he's a higher risk customer. But they're telling me that I can't do the balloon loans.

I want a qualified mortgage. So they created this big qualified mortgage thing – we want the safe harbor. Anytime you give them safe harbor, it's bullet proof. It's safe. There's no litigation there. But if I had my 8 criteria that I had the ability to repay – all those customers that are left behind – those are my low to mid- income people, and they may be in minority classes. So I may just say, I'll only do safe harbor mortgages.

Back in the day, you'd have proposed rules, and then you'll have final rules. Now, you'll have proposed, interim, and final rules all in the same document. This used to never, ever happen. You have the Federal register 1, then you'd have the final. This is absolutely insane. They'll keep changing the same rule over and over and over. This stuff goes into effect in January.

So we're not supposed to have a life. You're supposed to read and read and read.

Is that what you do?

More than we should. We did already. So along with all the changes, we still have to keep on top of the existing regulation and make sure we're working right. So the pile just keeps growing and growing and growing.

Basel III – I'm not a European bank – I shouldn't have to deal with that crap.

Although it's not exactly listed as a specific regulation, the Federal Trade Commission, section 5, there can be UDAP (unfair practices) – there can be UDAP in anything – “Oh, I felt like I was abused” – if we intentionally mislead a customer into signing up for a product and the customer didn't really understand what they signed up for, it's not what they bargained for. That's in everything. That can be in a deposit product, or a lending product.

[Back on the CFPB issue] I get mad in principle. They should have listened to us the first time. It took them five months before this stupid thing goes into effect, and Oh, yeah, we think that what they were trying to do was legitimate – do you think we're making this stuff up? That we're lying to you? We know our customer.

This whole thing is painting a broad brush on anything that looks, smells, looks like a bank – AIG, Merrill Lynch – not a bank. I was in Washington DC when this stuff happened, and how the Wall Street Journal got to the door – I was afraid to open the door, because every morning another headline with another big investment bank failing. Hey, what do you do for a living? I'm a banker. You'd be afraid to say it out loud.

How do you speak up? What are the sorts of activities?

You get involved in the OBA – they have what's called a contact banker program, so during open session at the state capital, we make sure there's face time with – we'll try to attend either a committee meeting – so that folks who've not been involved in that process before – who've not

reached out to their district folks have that time. That way, they'll go basically break up in two groups and run up and down the hallways. That way, if you have a specific burning issue – you're dealing with a citizen legislator – he's not a banker. He needs to understand from you about whether there's a specific issue up for a vote. So if we get a blast email from the OBA, today is the vote on – it is good, or its not good – we call. People need to understand that you have a voice – the whole country was founded on this – for people to become passive, oh my voice doesn't matter – yes it does matter.

Interview No. 8

What's your own personal background in the banking industry and your involvement at Valliance?

My background – is a long one. Started when I was 16, and I went to work at First National Bank and Trust Company in their night transit department – worked after school. Actually started when I was 15 – I started in May, and I didn't turn 16 until July and rode the bus downtown and then had a guy bring me home every evening. So I've been in this business continuously ever since.

The biggest part of it was with First National. Actually, two different stints. The initial one, where I worked, and even when I was going to school, I worked in the summers and whatnot down there. And worked there until 1975, and then came back in 1988, when they were first Interstate Bank and stayed through First Interstate, Boatmans, Nations, Bank of America. Then left in 1997, went to work at Local Oklahoma Bank – actual, Local Oklahoma Federal Savings and Loan. I joined a group that was buying the bank and converting it from a thrift to a commercial bank. Sold that bank in June 04 to IBC, and that gave me the money to come over here and charter Valliance Bank. So me and a group of businessmen in Oklahoma City and Norman chartered this bank and opened in October 2004. Brand new charter. It hasn't been done anywhere in the country lately – again, that's a regulatory issue, but certainly, we were probably – we weren't the last but we were one of the last banks to be chartered in Oklahoma from scratch.

Why go with the national charter?

The national charter, it was believed, was easier and quicker to obtain. And so we were chartered as a national bank and then two years later, flipped to a state.

Why?

Well, again, I think that for community banks, a state charter is really the best fit. You know, I recognize that the OCC, Federal Reserve, FDIC, they all have their field offices around and local people that they hire. But the state banking department focuses on one thing – that's the state of Oklahoma. And they understand the banking environment. The bankers. The economy. So, I think for community banking, state charters are the best place to reside. I realize there's banks that have been national banks for hundreds of years because of tradition, they continue to operate as national banks, but they'd be better served if they flipped to a community bank.

I think especially in rural markets, I don't think a national charter makes a lot of sense, but you see a lot of them out there because back in the early 1900s, they got chartered as a national bank and they just haven't changed.

There was a day when, if you were a savings and loan – a thrift – and a nationally chartered thrift, you had to use the word 'federal' in your name – and a national commercial bank charter, you had to use the name 'national,' or have the ',n.a.' at the end of your name. They changed the rules on – now, if you're a bank or a thrift, you can use federal/national, whichever. But I don't know if you're a national bank, if you still have to use the word 'national' or 'n.a.' in your name.

Regulatory environment? State commission / FDIC? Your relationships?

Excellent. I mean, these guys enforce the rules. They're like the referees. And, you know, it doesn't work out too well for any sports to yell at the referee, so it probably doesn't do any bank any good to yell at their referee either. Sometimes, you have to put on your mean eyes when you disagree with them, but you better have a good relationship with them. In fact, you know, they're not just a regulator. They're also a resource. They understand and know the rules, at least in their mind, better than you do, and I mean, if you have a question – I had a question recently, just two weeks ago, that I went out to the state banking department and discussed and got clarification – and it really changed my mind about something that I firmly believed for most of my career, and I realized I was probably wrong about that. I thought it was a black and white issue – it's a little more grey than I thought it was.

For example, we stress test our commercial loan portfolio, and when we put together our stress testing model, that was proprietary – I mean, you can buy stuff off the shelf – the problem with a small bank buying stuff off the shelf – all that stuff is really made for a bigger bank. And so we did our own deal, so we sent it to the FDIC and asked for their comments on it before we actually rolled it out and implemented it. So it's not an adversarial relationship with your regulator. It shouldn't be. Now, you know, and just like me, you may agree or disagree about how much regulation is a good thing and whether you're being overregulated – that's a matter of opinion. But, I think having a good relationship with your regulator is using them as a resource and try – I mean, they've got the power to beat you with a pretty big stick if you don't comply with the rules. You need to have a good relationship with them and be able to discuss if you want to get up against one of those areas.

Bear in mind, there are laws and then there are rules. And I view laws and rules in my mind like a highway. There are striped lines on a highway and then there are dotted lines on a highway. You're not supposed to cross the striped lines. Those are like laws. You obey the laws. But the dotted lines – the dashes – those are like the rules, and you're supposed to stay within those rules, but it's OK to get out here and maneuver around back and forth. Because rules need to apply to certain circumstances, not just blindly – and that's the one thing, I guess, I get into a big hoorang with a regulator, it's because they are blindly following the rules rather than applying the rule to certain circumstances.

Scale. For God's sake, why would you govern my bank in the same way you govern Bank of America or Citibank. Scalability is huge for me – you gotta be able to take what we do, which is pretty simple compared to those banks, and apply the rule to how I do business. And you'll get a young regulator who's just going to apply it across the line, like it is the law.

The OCC as interactive as the state/FDIC?

Absolutely. I've never been regulated by anybody I didn't like. We're also regulated by the Fed because we've got the holding company.

Are you the one person interacting?

During examination, it's across the board. Almost all department heads and even some supervisory staff will interact with the regulators. But bear in mind, that needs to be just a simple exchange of information – if there's going to be any interaction, especially if there's finger pointing or chest bumping, that's done by me, typically.

And in fact, they generally come in with me first to do a pre-exam interview, for the lack of a better word, and discuss the scope of the examination, they'll ask me if there's any areas of concern that I have as a CEO. And then, I generally don't see them much, unless there's a particular issue they want to discuss, or if our people think there's something they want to discuss. And then they have the exit interview, which is very serious, because that's where they go over the findings. Then they come in again with the formal report, which they report to the board of directors.

Your interaction takes place outside the exam?

Yeah.

On the other way round – are there individuals there who you know and have personal relationships with?

Just like, on this issue I had, there was no reason to go to Mick, I went and met with Dudley Gilbert. So, I mean, yeah, you're going to go to the person who it's appropriate within the organization to talk to.

What do you think the role of regs on industry performance and your bank's performance?

Well, outside of the early 1900 monopoly and trust busting, I don't really think regulation should have anything to do with financial performance. In fact, I think that's one of the problems is when regulations get into areas that do affect financial performance. Now, regulation always affects financial performance from the standpoint of – there's a cost involved in complying with regulation. So, that cost, that expense, that G&A expense is always going to be present at any company based on how vigorously they're regulated. Our costs have gone up over the past five

years as a result of Dodd-Frank and what not. But when they start tinkering with how an industry money, that's when I have a problem.

For example, I had a real problem with the interchange fee laws that were passed, because that's government price fixing. That's saying that this is the maximum amount you can earn. It's just like this recent talk about breaking up the big banks that's like saying, well, a maximum size that you can grow to. You know, it shouldn't be banks that are opposed to that. It should be every business because, OK, they're applying it to banking today, they come from you today, they come for your neighbor tomorrow. Any regulation has this creep, it just seems to – and even if they said, well, this is just going to affect big banks, it trickles down to everybody, and then it migrates over to other industries. I look at this tree out there – how big can that tree grow? As big as it can? Because once it stops growing, it's dying. To say that you can only grow to a certain size and if you grow to that size, then we're going to punish you, I mean, my God, that is just – that flies in the face of the capitalist economy for sure. So I really get pretty vigerous when I see those kinds of things coming down the pike that are going to affect overall performance of a bank. I understand that there's going to be a financial burden just, with any regulation. But when they start tinkering with your ability to earn money – they're doing that right now on these mortgage rules. They're driving small players out of the mortgage business because they have created rules that small banks cannot afford to comply with. And therefore, those small banks have to get out of that business, and that means that there's customers in those market places that are now underserved. Who gets hurt the worst? They're generally the people in the small rural communities.

This is where I start drawing the line and fighting regulation. Just as too much money going into the mortgage business did what to values (up!)? Too little going into the mortgage industry, especially residentially, has just exactly the reverse/converse affect. It's the same effect, just on the other side. It drives values down. If you wanted to buy a house – and this was just the way the world worked, and there was no mortgage industry, and you had to pay cash? What would a house be worth? Well, not very much, because people couldn't afford to buy homes.

So when you create an environment where you have – I'm not talking about cutting, I'm talking about slowing the flow of funds into the residential mortgage market, that drives values lower. What's the commercial value of a rural community? What's the enterprise value of a rural community? What are those businesses in that community worth? Not very much. The value in those communities is mostly almost historically in real estate. And when you hurt the value of real estate in those communities, you hurt the commercial value of that overall community. It's a killer. Now, I said when they slow the volume of mortgage money – and I say that, hell, you can go online and get a mortgage loan. But here's the difference. And I'm speaking now, not so much in my capacity as president of this bank, but as the former chairman of the OBA – I want rural banks and rural communities to thrive. I want rural communities to thrive. Not just survive. And the only way they can thrive is if there is a local bank – or I should say a local banker – there's a local banker who understands the market who knows Chris and his family, cause his dad banked with Chris' grandfather 50 years ago, who knows the players and is willing to take risks based on that knowledge and understanding. Some online mortgage guy isn't going to take that type of risk. Oh here's a really nice house on a really nice street in Laverne – yeah, I'll make that loan. Here's a doublewide trailer on 60 acres. Hunh unh. And you know what, there's more

of the double wide trailers on the 60 acres than there are nice homes on quaint little streets in a lot of rural communities.

So that's where I stand up and start screaming is when the regulatory environment, either accidentally – bear in mind, regulations are just the result of laws that Congress passed – and just like Nancy Pelosi said, well, we need to pass this bill, we need to find out what's in it. These guys don't have a clue when they're passing this crap, and as a result, what's the FDIC and the Fed and the OCC going to do? They've been handed this law, now they have to write a rule. They may disagree with the law. They may think the law's stupid. But they don't have a choice. They now gonna have to write rules. And so that's why we spend a lot of our energy at the state association and the national association trying to fashion – not to eliminate regulation. Regulation – you know, regulation is nothing more than the rules that business in this country plays by. You know what? I would even argue that back in the day, when there weren't many rules, back in the late 1800s and early 1900s, the lack of rules did create some abuse, but it also created the environment that companies like US Steel and General Electric and Ford Motor Company were birthed into. Had they not been able to grow unfettered, almost as monopolies, yes – you know, Standard Oil got busted up – had they not been allowed to grow unfettered, the United States would not have been able to take a position as a world leader and superpower in World War 1 and in World War 2. Certainly, that's what gave us the girth and the dominance in the world economy.

Now, was Rockefeller abusive? Hell yes. Was Carnegie abusive? Yes. They took advantage. But had they not been able to build that kind of strength and girth and size pretty much unfettered without government interference, who knows where the United States would have ended up. Now, it's just like the unions. There was a time and place for a unions. The roles have almost flipped now. Where management was abusing their employees and their labor, now, labor is – you know – if management doesn't play footsie under the table with the labor leaders, then we're going to shut down the plant. So it's almost in reverse of what it was. You got to have rules to do business by. But in certain times rules go too far. And just like my example of what's going on in the mortgage industry today, it depends on again, in response to one of the worst financial melt downs in this country since the Great Depression, the pendulum has gone too far.

Now, ironically – and this is what I call the unintended consequences of regulation – the very people that the federal government would've liked to have seen be helped and assisted by some of the things they've done are the very people that got hurt. Let me give you an example. I use this example all the time – you'll appreciate this. I'm sure you've probably run across it because they still enforce it vigorously today – it's called fair lending. Well, who could be against fair lending? I mean, sure, we all want to be fair. And honestly, when the regulations were passed, there wasn't a lot of hew and cry against it. When the regulation passed, it was passed to really protect one class of people – blacks. Asians weren't considered a minority then. Hispanics weren't considered a minority then. Women weren't considered a minority then. It was back in the 70s, and blacks – Africans Americans now – were the ones that were being theoretically – and I'm certain in some situations were abused, taken advantage of, charged higher prices on loans, if they could get them.

So they passed fair lending. Again, you know, nobody was against fair lending when Congress passed fair lending, so now, we've got to write the rules here. Here's the law, now what are the rules? Historically, when banks were examined, they looked at bank policy, and then they said, OK, does this loan apply and meet this policy? Yes or No? It was black and white, because that's what they did. When they started to do the fair lending exams, here's your policy, got that down. Here's a loan you've made. I want to see how that compares to the loans that you've turned down. Have you turned down loans that look like this one that you approved? So then, why did you either make this one or turn that one down, viz a viz this? So now, we're going to have to homogenize what we do. We're going to have to treat everybody in every circumstance exactly the same. Now, especially, here in this bank, I can pretty much impose my will on the people that are right here under my thumb, and I can probably tell you that we can pretty much make the same kind of loans across the board because we talk enough. But we've also got a bank in Norman and we've got one in McKinney, Texas. Well, I can't control what they do, so how I can control – how can I treat both these customers equally so that I either turn them both down or approve them both with total color blindness? Ah. Credit scoring. What I call black box scoring. Credit scoring's not quite as simple as a lot of people believe. Credit scoring – a lot of people believe that their FICO score on their credit report is what banks use. Well, that's a component of what I call credit scoring, but they load all this information into the black box, including the FICO score, and of course, that's big piece of it. And then, that black box scores that application, and either it does or it doesn't pass. So, now you've got to set – OK, where's the bar? How high's the bar? The truth is, that took some practice. You had to make enough loans to know, well if the score in the black box is 100, so everybody over a hundred gets approved and everybody below 100 gets turned down, is that OK or am I having too many defaults, does that need to be 125? So there's some experimenting. You know, you've got to fine tune. But, eventually, most banks adopted that type of underwriting. Who do you think got disenfranchised in that process? Who do you suppose had the lowest scores? What about people who have poor credit? People who don't have longevity, consistent longevity in any jobs – which just happens to be African Americans as a percentage. So the very people that fair lending was passed to help get disenfranchised by fair lending because of the way it's implemented. Congress had every good intention of helping the African Americans. But when the rules got written, and even when the rules were written, they had every intention, even when they began those exams, they had every good intention. But when the banks responded to those exams and wondered how we could do this without getting our hands slapped, they had to come up with this way to treat every customer the same. And now, see, Dodd-Frank is causing even almost all the products to be the same. Where I might have a product over here for this low to moderate income household. But, oops, what about this guy? My point is this: follow this all the way through with me: now you've got this segment of the economy that's disenfranchised by the regulation, by the – does that mean they just go unserved? Nobody's going to step up and serve this segment of the community? Well no! Somebody's going to step up and serve this segment of the community: and that was the birth of check cashers and payday vendors. And so, what became the catch all phrase – subprime lenders were essentially birthed in fair lending.

So you can see the unintended consequences of regulation can really bite people in the butt, the very people that it was supposed to help. And now, we're doing sort of the same thing with Dodd-Frank on the product side that we did on the human side with fair lending. You've got too many products here. Let's just come up with a qualified mortgage. Let's just come up with one

thing that everybody gets spoonfed. Well you know what? That doesn't work for everybody. Because you're different than I am and your best friend in school and our roommate at OSU is different than you are. We're all different. And we all conduct our business differently. And think about the future. It's really going to be different in the future than it's been in the past. And I think people – today, it's been fading for decades, but when somebody goes to work that's your age for a company and stays with that company for 40 years – those days are gone. And so, since people are mobile, we're getting weighted on at Buffalo Wildwings by a waitress – she's probably 20, 22 – and we're kind of talking to her, and she's got back from Thailand – well, what were you doing in Thailand? Well, I worked over there for about a year and decided to come back because I got bored of it. Kiss my ass! Are you serious? I've never been to London or Paris. This 20 year old is going to Thailand? But that's the world we're living in, now. Does this piece of paper that the CFPB makes – now, spent over 10,000 pages creating – really work for everybody? And that's a problem of what we're seeing in Dodd-Frank – this sameness mentality – plain, brown wrapper products. It's the special products for people who have special needs that get us into trouble. Here' let the government, who knows everything about these industries figure out what's best for your customers.

Toward consolidation?

Have you got the rest of the day? Don't get me going down that road. Let me give you a great example. They have now penalized the five year balloon mortgage. All of the sudden, that's an evil product. It's served many rural communities for many, many years. But now, it's one of those evil products. I don't want to get too deep here. Interest rate risk management. You've studied, obviously, banks enough to understand that we fund our loans by borrowing money to fund those loans. And most – the biggest part of those borrowings come from you, who have deposits in the bank. And today, you know, in fact, dating all the way back to the seventies when they deregulated how much interest you could charge on different types of accounts – that was fixed by the government at one time. Since they've deregulated that, now most accounts bear some interest. Unless you're in a pure free checking account, you're going to be paid interest on your checking. So that's our cost. That's what we borrow from you. That's our cost of borrowing from you. And today, that's real cheap. But then, you can get a mortgage loan for three and a half percent. Now, if you're a community bank, and you've just got a small loan portfolio – you're not a CitiBank or a BoA – you have to be sensitive as to how far out what we call duration on the maturity scale we're going to go. If I make you a 30 year mortgage loan today, and my portfolio – and that's what community bank – that's one of the problems with these new mortgage rules. It's like the banker in Laverne tells me – well, I only make five or six residential mortgage loans a year. How can I afford to do all this for five or six loans? So, they're keeping those loans – they're not – they don't make enough loans to package them into a security and sell them as a mortgage backed security. So they're keeping them on their portfolio. And today, if I'm making three percent, and I'm paying you .2 percent interest on your checking, well, sure I can make money. Well, what's the rate ten years from now? I've still got that 30 year mortgage ten years from now. It's got twenty years to go. Am I still paying .25 or am I paying five percent? And now, I'm upside down. And when I get examined, I get examined for what they call interest rate risk, and as a community bank, I have to be sensitive to that interest rate risk. So, when I make mortgage loans in my community, I typically make five year balloons. That doesn't mean I'm going to pull a mortgage out from under you at the end of five years. It just

means I want the ability to reprice based on my costs today. That's the way business has been done in rural communities for centuries.

Well, that's a bad deal, now. So now, I can't offer that product. So, consequently, you know, now, if I can only offer a 30 year product, well I'm – I'm out, because I can't put that in my portfolio because the regulator's now going to come in and say, woooo, interest rate risk! So, what does that do? Well, that drives it to a bigger bank that can package securities. Now. Whether that's intended or unintended, I don't know. The reason people kept telling you to see me – I'm one of the leading conspiracy theorists in the country. Well, let me tell you. Just like they've taken over student lending. They've taken over most of farm credit. You know, we've been talking about getting rid of Freddie May and Freddie Mac now for five years. You know how much Fannie Mae and Freddie Mac are going to make this year? Net income? Its projected to be over 100 billion dollars. You know what the most money any fortune five hundred company has ever made in history? It was 42 billion dollars by Exxon about seven or eight or nine years ago. So this year, Fannie Mae and Freddie Mac are going to double the most money ever made by any company based in the U.S.A. And for five years, the government's been saying – well, we need to get rid of them – they're making so much money now, they can't get rid of them. And you know what? They're making so much money that they can say, you know what? It doesn't look like a lot of this banks are serving the residential mortgage community in this country very well. But wait a minute! I can't comply with your regulations! That's not my fault. Well still, we have to protect those markets. So now, the Federal government does what they do with student lending. Fannie Mae and Freddie Mac can take all the mortgage lending in the country. And it's easier if you make everyone scurry out of these smaller banks – now you've got a few big players. It's easier to say – you guys, it's a monopoly – we got to break this up – and so the government ends up taking the whole thing.

Honestly, do I think they think about this? God, I hope not. But there's a part of me that does. There's a part of me that says, don't listen to what they're saying, look at what they're doing. And if you look at what they're doing – it's kind of scary. Let me take this one step further, if you will – now, this is conspiracy theory – this isn't real – don't write this – Think back, you've seen this before, I can pull it up if you haven't – have you seen the county-by-county voting in the last presidential election? You've seen it? Isn't it amazing how, when you look at that map, especially if that map were on the wall and you looked at it from here, you'd think, well, Romney won. There's more Romney than Obama! And that's because geographically, Romney carried most of the rural areas and does. And the population centers, you know, they're these narrow little areas – but by county, it's just – it's this big on a map, but there's five million people in that county, like Los Angeles. It's just one county, but it's a huge number. Now, again, conspiracy theory – and in fact, you look at Texas – of course Oklahoma was all red – you look at Texas – north Texas, red as Oklahoma. Except right in the middle there – Dallas County was blue. All of these population centers tend to vote democratic. It's the rural areas that tend to vote more conservatives. It's the rural part of the country that filled in most of that red. Now, again we're talking conspiracy theory – what if you're a democratic strategist, and you say, demographically, we're all ready seeing – and have for the last three or four decades – massive migration from rural to urban areas. And in fact, in Oklahoma right now, we're – the number's around sixty two percent of the population is urban. But they project in twenty years, that number will probably be as high as seventy five. So there's already this migration. It probably

isn't going to affect the presidential elections, but what would it do to county, state, local elections if you could hasten the migration out of rural America and into those urban areas? Where those conservative votes get diluted by this huge liberal population base? And one way to hasten that, statistically, communities that lose their local bank dry up and blow away in about twenty years. So what if you could force bank consolidation and either eliminate the banking services to these communities? Could that potentially hasten the immigration? Now, I don't know. I don't have the answer. I'm just saying.

So, when you talk about, is there this covert thought that let's force consolidation on this industry, let me tell you something – my last act, if you will, as chairman of the OBA – I did seven bankers' night out – we ask bankers from that region to come in and we all meet together. And I ask, show of hands, who believes that the Federal government is encouraging bank consolidation? Just damn near every hand in the room (went up). I went on: who believes that it's the Congress that's encouraging that consolidation? Hardly a hand. Who believes it's the administration and the bank regulators? Who believes that it's the regulators that are encouraging this consolidation? There's no question: you get this ya ya from the government that everybody that's a player that deals with these people every 18 months and intimately and off and on in between, they've got this message somehow that those regulators want to encourage consolidation. So I would, again, say, I can't hear what you're saying because what you're doing is so damn loud. And that's kind of how it is right now.

That's a long answer.

How do you know what's in the rule book?

When you're CitiBank or Chase or BoA, you take Dodd-Frank and all thirty thousand pages or whatever the hell it is, to the three or four of attorneys and paralegals that you've got – and you say, you guys read these and you guys churn out our policies and procedures we need to comply. What do I do? I mean, we got forty eight employees, I could hand out Dodd-Frank equally among all of them, and we'd still not get through all of it. So you do have to rely on your associations – the OBA the ABA – to tell you, we've sifted through this and this is what we think is important and pertinent to your bank. But it's a joke to believe that any community bank could go through and understand everything that's in Dodd-Frank. Bear in mind, there's a lot of stuff in Dodd-Frank that doesn't have anything to do with community banking. But, nevertheless, you have to proactively address some of that stuff, even though it doesn't apply. You have to prove it doesn't apply. If you don't engage in proprietary securities trading, you still have to address that by proving that you don't engage in that. Now, how do you prove that? Well, the way you prove that is that you've got a director from the board of directors that says, "Our bank does not engage in proprietary securities trading." And of course, you've got your securities ledger you can show. Because banks do buy treasuries, or mortgage backed securities – they do buy securities. We own municipal securities. But we don't trade them. They're an asset in our portfolio just like a loan is an asset in our portfolio. Nonetheless, under Dodd-Frank, we still have to prove – and that's just silly. But that's the law.

There's a whole cottage industry, which has grown up offering services. In fact, we offer one through – the OBA – one's based in Texas, one's based here in Oklahoma. It's just a package of

services that puts out Dodd-Frank alerts on any new regulation that might affect your bank. And they'll come in and do audits of your bank and tell you, here's what you need to do.

Would you fair to say: you're relying on other folks to tell you what the rules are? You don't pay attention to the rule book itself?

You know. How would you put this? You're paying a whole lot more attention – and this is the first time I've ever answered this question – you're paying a lot of attention to the rule book. If you're an NFL or NBA team. Those coaches, the back office, even the players, know a lot about the rules are. When you start paying little league football and basketball, you know what the rules are. You pay attention and you apply the rules. But you don't study and understand the rules to the extent that those NBA ... likewise, I think small banks, small players, they look at the rules and they read into them and study the parts that really apply to how they conduct their business. And those, they understand, they pay attention to. The rest of us – they rely on somebody else to give them advice. And then, we have an auditor who comes in that we hire – it's called internal audit, but in most cases, small banks will contract it out to a third party, even though it's called internal audit. But CitiBank and Chase and BoA and Wells, they're like the professionals. They understand the rules, and they write their own policies and procedures. Where we might rely on, hey we need a new policy for the qualified mortgage – we might hire somebody to do that. So it's a canned product. And we'll take the canned product and tweak it to meet what our needs are. We won't just say, OK, we got it in the mail today, so let's put it in the book. We'll make sure that it make sense for our organization, but we won't sit there and write one. Now, on things we do do on a day-to-day basis – we have a compliance person that does write most of our compliance rules, policies and procedures. You know. It just kind of depends on the size bank you are as to what level you're actually reading and interpreting and writing versus relying on third parties.

Ambiguity: the dotted line and the stripes ... do you try to take advantage of that? Are you looking for ambiguity?

Let me tell you something. Let's just take consumer products, for example. I look at Chase. I think they do it about as well as anybody. They market about as well as anybody. So I watch – and what Chase does – I say, OK, maybe not today, maybe not next week, but down the line here, we're going to have to have that product. So we're not – I don't – that would be what I call pioneering. And, you know, I always tell people, here at our bank, pioneers are the ones with the arrows in their backs. We're not going to pioneer. We're going to follow. Lewis and Clark can go blaze the trail, and we'll go down that trail after a few people have followed. So we don't typically go out there and stretching on a situation. So before I wound up with arrows in my back, I went out and talked to the state banking department: here's what I'm thinking about doing, can you help me out? Now you know what they did? They said, Swick, here's the law, here's what you're doing. What you're doing probably doesn't comply with the law. Exactly. But I understand why you're doing what you're doing, and it absolutely makes sense, and we would even tell you that that law, the way it is written is flawed. So what we're going to do is this: we're going to take this and care out this one group that you're concerned about and we're just going to set it over here and say it doesn't apply to your legal lending situation. And we're just going to agree that that's what we're going to do.

Now, there's also a rule that says, once you make a loan, if at the time it was made, if it was in compliance, then nothing in the future that happens – loss of capital or changes of rules – can effect – you're grandfathering – once you made the test, you've made it forever, even though if you were making the loan today, it wouldn't make it over the bar. So I don't have to worry about Mick Thompson and Dudley Gilbert getting killed in a car wreck and the new guy coming in and saying this doesn't work. Also, your federal regulator has to go along with what the state says.

So I covered myself in that situation even though the exact interpretation of the law – so I was outside of the white lines probably a little bit, but they granted me some leniency just because they did what – going all the way back to the beginning of our conversation – instead of just blindly following the rules and regulations, they applied it to my circumstance. And said under that circumstance, you're not creating any additional risk. So we're OK with carving this out. They wrote me a letter, so I'm golden. But had I just gone out and done it, I would have been toast. Had they come in and said, wooooo! Here's the rules, and this doesn't comply. So I checked, just like the winery did. I'm at least grandfathered on what I've done. Now, if the same situation occurred five years from now, and the new guy at the state says, I will apply it or not to your circumstance. That drives me nuts. That means that anybody that can read at a fifth grade level can be a commissioner. Because if he's just going to blindly apply the rules –

The commissioner's role is to employ discretion ...

Yeah. I would tell you yes. He is the senior referee. I had a debate out here over – when we make a loan, we grade that loan a certain grade – all banks – we all use different grading systems, A, B, and C, or one, two, and three – in our system, a 1 is just as pure as the driven snow. And a six is black is tar. So that's the grading system that we use. And then, you understand what a CAMELS rating is? Your CAMELS rating gets determined by – at least your “L” – your loan portfolio – actually your “A” – your asset quality – gets determined by how you risk rated that loan portfolio. Now, they were going to downgrade us, and we did not see eye to eye on it. They were going to downgrade it to a five, which in our world, is one step out of the drain, and I felt like it should have been a three. And me and the lead examiner got into it – we just did not see eye to eye on it. And Don said, Swick, we're never going to agree, but I could be wrong. What do you say if we call Mick, and I said, OK. So we got Mick on the phone and talked to Mick about the deal. And Mick said, frankly, from what you've told me without looking at anything, you're both right, and that isn't going to work out for anybody. How about if I send Paul Qualls – another examiner in the state – what if I sent Paul out to look at this file, can we agree that having a third set of eyes come out and look at that deal, and I'll tell him – he'll understand what the circumstances are. And will you both live by Paul's decision? And then we both said, sure, absolutely. And he came out and graded it a 3 – hallelujia!. But my point is, that's the role of the commissioner. To deal with those circumstances where bankers and examiners, field examiners, don't agree eye to eye. And then, of course, he also has to deal with other issues like capital.

Interview No. 9

Background? Industry and the bank?

I started in banking in 1989 with the FDIC. I was a bank examiner for seven years. I traveled around the late 80s when banks were failing frequently. Mostly, I was doing examination supervision; I was really involved with liquidation. Still, some banks were on the edge of liquidation when I went in. Primarily Oklahoma. We started when things got better here, probably 92, 93, then we started going other places that were suffering, like on both coasts. So I spent four months in CT, four months in NY. And then my last project with the FDIC was actually looking back at some of the failures and working through how those failures ... What worked better for the agency in dealing with failures?

But that was my last project with the FDIC. Then I started here in 1996. I was hired here directly from the agency when I decided to get a real job and get into banking. I called two or three bankers I knew, and one offered me a job over lunch, before we even ordered, actually. I was vice president of the cashiers, which means – at that point, we were a lot smaller, we only had one office, and we didn't have any ATMs. It was definitely a different bank. We're in Purcell. We have about 30 employees. We have our charter in Purcell even though most of our HQ stuff is here in Norman now. But the bank has grown over time, so my responsibilities have shifted a lot. The bank grew from one office, we now have nine offices statewide. We were, at that time, probably about \$55 million in assets, we're now about \$340 million in assets. The dynamics have changed greatly. I used to do everything from HR, to accounting, to IT, everything. Product development was under me. Now, I focus mostly on financial areas. The facilities are still mine, so all the branch construction has been under me. And also, I oversee IT, even though I have an IT manager who does most of the real work.

There is a lot of compliance issues – with IT, obviously customer information being very private is a very big deal. As we go more into the internet, mobile banking, even scanning checks. Are those channels secure or not. So there's a lot of issues, intrusion detection, audits, software and hardware tools we employ to keep our stuff safe.

State charter bank always?

It has been. We actually used to be FDIC regulated and state, which basically means it was a state non-member. Now it's a state member, which means we're regulated by the Federal Reserve.

How long have you been a Fed member?

Probably right after they hired me. Because they hired the only good FDIC examiner. (Just kidding). Probably 97, 98, we made the change. Once our commission improved at that point, we were – when Pat Mayes bought the bank in 1990, when he bought the bank he was basically on the verge of failure. He didn't want to buy a failed bank – he could have waited and gotten pretty good assistance from the government had he done so, but he didn't want to buy a failed bank. He bought it in 1990 and turned things around dramatically. Continued to turn things around when he hired me. But the classified assets were still fairly high at that point. You know where Hollywood theaters are now? All of that used to be real estate that we owned. Those loans went bad that we made on that real estate. So we got the real estate. Well, once we sold the last piece to Outback, he took us all to Cattleman's Steakhouse in Oklahoma City to celebrate and took all

the officers up there. That was a fun thing, and it was a sign that, oooh, here we are, coming out of this. In 97, we build our first branch off of Highway 9. And after that, we started growing and taking off and doing well.

How would you characterize your regulatory environment? Interactive?

The state banking inter – Mick Thompson is a former banker. He knows the drill. He knows what's important and what's not. The examiners who work with him are very good, very competent. We'll be thinking about a new product or a new service – it might be – well, I've seen that before, and you might want to think about these things. They're very proactive. They won't tell you what to do or what not to do – they'll tell you to – we're not going to call them and say, we want to do this illegal thing or something that's against regulation, so stuff that may be, as you said earlier, it's not really regulated yet, will it be, is it something that might be, obviously, monitored by the CFBP. We're very sensitive to consumer laws anyway. I'm a big free market person. If a bank is screwing you over, switch banks. There's like 40 different banks here in Norman. Go switch. Use another one. So, if the regulator has to tell you how to protect the consumer and keep them from evil harms that the banks are doing, there's something wrong.

Do you have – how about the Federal Reserve – is it the same?

The Fed is pretty cooperative. Probably not as much as the state. They lost the local examiners – the local examiners lost a lot of their autonomy, it appears, that may be because of the banking crisis of 2008 to 2010. But a lot of the governance and a lot of the decisions are made, it seems to be, out of Kansas City, obviously, our Fed district. And so, the local guys coming in and talking to us and working out issues, which has been our past history, now, there like coming and saying, well your --- may look like this, so you may need to do these things. We've had similar products before and we've never had to do it before, so why now? So it's a little bit adversarial – but it's not cooperative.

They've got less discretion than they used to, maybe?

That's fair to say.

In the 20 years – How do you think it's changed?

It's kind of interesting, because it goes – I always think it goes in cycles. Back in the 80s, obviously, when I was a regulator, it was very focused on safety and soundness. Compliance and consumer laws, took a very much a back seat. They were like way in the back of the bus. And then, when things turned around in the mid 90s here, it's when you started to see more bank secrecy issues, more real estate law issues, more compliance type stuff. In fact, probably right before I got here, we went through a compliance exam where we got reamed over flood insurance – and we didn't have that many properties in flood zones. It's something that just two or three years earlier were just a blip on the radar, and those loans were still there. So now, four or five years ago, safety and soundness was a big deal. But compliance was still there because some banks were bending the rules – mortgage companies were bending the rules – so regulators came in and said you've got to do this better compliance wise, in the meantime, you've got to

make more money because you're having losses on the loans. Earnings pressure, capital pressure. And now the compliance stuff, and so it's like, really? Its like you can't hire more compliance people because they're telling me to clean up my earnings.

Different compliance examiners and safety and soundness examiners don't seem to communicate very well. You've got one group telling you one thing and the other telling you something. The state does not really do anything compliance wise. Usually with a safety and soundness examination, at the state and Federal, they'll do bank secrecy, which used to be a compliance issues.

How do you interact? Is it all you? Or is it you plus others?

It's supposed to be me plus others. Based on my background, I've done a lot of it in the past. There's another lady who now works for us – Penny is our COO – she's an auditor in her past life. She was a CFO in her past life, so she's done a lot of similar things to what I've done. Just a little different perspective. She's also detail oriented. I'm not as detail oriented. That's why she works real well where she is. She has a lot of interaction with our auditors – mostly our external loan review people. We have external auditors – we just got done doing their report. We've got auditors for IT – a lot of outside groups come in each year and audit different pieces of our bank. We kind of split it up ...

The proactive communication?

Most of that will go through me. That's what we have something going on right now in the bank that will require regulatory approval, and once we get ready to pull the trigger, we'll call the regulators and say, here's what's going on.

How much is performance influenced by regulatory environment?

I guess we should couch with saying, again, I'm a free market person. To me, I don't know – there's probably some things that – basically, the regulators have inhibited us a great deal – I guess there's no nice way of saying that. They have – there's things that we have tried to do or would have done a lot quicker on the products and services side – instead, let's think about all the compliance issues that go along with this. Now, instead of, what's right for the consumer, we have to think about what's right for the regulation, and then we can focus on what's right for the consumer.

You're the first person to mention opportunity costs first. Specific example of a product or service that was slowed?

We were one of the first ones to adopt overdraft privilege – where basically, instead of banks back many years ago when we started – we would literally go through the stack of bad checks and say, we'll pay this check and not this check. And we would charge a fee regardless of what the decision was. Well, now that process got automated, where, assuming, if you came in and had an account here, we'll give you a five hundred dollar privilege. That says you can dip down below five hundred dollars, we'll automatically pay. It saves you embarrassment, and it saves me

time. That's one the regulators came back and said, curtail it back. And it used to be – we used to probably make 180 thousand a month on NSF and overdraft fees, and now we make about 100 a month, and we're bigger than we were. Not because we were cheating the customers. One, people are writing less bad checks. They've got mobile banking – they know what their balances are. But debit card transaction – you can't allow that to overdraw the account unless you give the customer an opportunity to be notified that the debit card transaction will be rejected. So, how do you do that? How do you provide that notice? That creates the cost of technology to do that. We basically, some of these things we just couldn't do. So again, we couldn't allow that debit card transaction to create – even the possibility – so it just cut it off.

Student loans?

No. We never have done them. Don't like them.

Mortgages – people are complaining about that – getting out of the business.

Actually, we did get out of the business. We used to have a full service mortgage department. We had probably, when I first started here, we probably had 10 to 12 people employed in our mortgage departments. Had a fair amount of loan originators out there – and people in the back room would package them and sell them to other investors. We still service some loans for Fannie Mae – we still have some old legacy loans – they have about an average of seven years on them, thank goodness. We used to originate mortgage loans. About two years ago, we kept downsizing them – basically originate, then you process it, gather information, then you underwrite it, and then you close it and make the deal. We eliminated the closer because we outsourced it. We eliminated the underwriter – outsourced it. We reduced all of our costs as much as we could – so could we outsource anything else? And we had a guy here who actually just quit the company – that he and I talked, I'd really like for you all to originate loans, and he said, we've been that road before and we don't want to go down that road. I want you to have your originators in our offices – lease space from us. And if we have a customer who wants a mortgage loan, they'd go see Joe over there – and we'll be out of the picture except that they'll pay a lease rate. Legally, that's all we can give – we can't give a reference – that's all fair lending. So anyway, they started doing that in November 2011. And they pay us a monthly fee and they now have assistants in a couple of our offices, so we get \$4000 a month rental income from them. They are owned by a large construction company here in Norman and OKC. So we've gotten some of their loan business as well, so it's far more profitable without any of the headache that comes along with mortgage lending.

How do you know what's in the rule book?

You just guess. (Joking). It is overwhelming. They have greatly enhanced the amount of work that we have to do. We have a lady that loves compliance, thankfully, and keeps following it for us. She does a great job, but we also – we used to have just her – she did all that. Well, she got burnt out. Her husband divorced her, and she moved to Dallas and took a job down there for a few years. So after a couple of years, she and I talked – our compliance had not been as good as it could have been – she still had family here, and she's very much a family person, and she says, yeah, I can't go back. And I said, yeah, actually you can. Now, though, she only does compliance

and operations compliance. She used to do all of our audits on compliance – now she just does the work. We have another lady who does bank secrecy and fraud. So now, instead of one lady doing multiple jobs, we have now probably six doing the stuff that she used to do just about seven or eight years ago. Is compliance a big deal? And require a lot of work – that’s how we deal with it – by devoting resources to focus on it.

Those three books are what I used when I was an examiner. There ended up being a fourth one. Then, finally, it went digital. I can’t imagine how many books there would be now if it wasn’t digital. The ABA is a great resource, we use that a lot. OBA does an awesome job as far as providing us updates, information, or anything else.

It seems like that’s sufficient – the bullet point changes they release:

And a lot of it doesn’t apply to banks our size. Now, we have new capital guidelines coming out, Basel III, some of which applies to us and some doesn’t. And everything has a staggered deadline – is this 2014 or 2015 – and as we’ve seen with health care, a lot of that could change anyway.

Is there a difference between the written rule and enforcement?

There probably is, because – I know, there’s probably been a number of times where, you’re like, really, we have to do that? And it kind of comes when regulators come in and say, well, you’re not doing this right – or one of our auditors – that’s usually when it gets caught because they come in more frequently. Vendor management is big with IT – and if we’re doing vendor management, and you have to do all these things with – and I keep an Excel worksheet, and there’s certain vendors I review their financials on – do I review every vendor? No. But based on what our auditors are saying, I have to do more.

How often are you surprised by what you expected versus what actually happens?

Over the last five years, a lot. With the economy the way it was – I think a lot of it isn’t surprise as much as disappointment. For example, the state came in and told us one way on what we’re supposed to do to improve. The Federal Reserve was here that year, said nothing, just agreed with the state. Said it sounds good. Next year, the Federal Reserve comes in, and they’re the lead regulator, they were there the year before, and they said, oh, well, you need to do this and this and this and this, too. And it’s like, we’re better than we were a year ago, and we have to do more? And yeah, we weren’t the lead last time so we didn’t think it would be appropriate to tell you that. It would have been handy had you told us that so that we didn’t go through all the steps. So, do they always follow along and are there surprises? Yeah, there are surprises. And fortunately in our case, we’ve had success in not having those big bad surprises in the long term. The Fed came in last month – while I was on vacation – there was some higher powers from the Federal Reserve that came to see us just because of they knew of our condition and how it’s improved, and they wanted to know how – they wanted to visit with a good bank – that had done the things we asked for?

The surprises, are they happening more or less?

Less often. And it's probably because we're more in tune with staying in tune.

How have you improved at knowing what the rules are?

We really – it kind of goes back, first of all, to the associations and the information they're putting out. We literally get a daily update from the ABA, that says, here's what Dodd-Frank changes are coming up in the next week. And there's usually three or four things – something like, I do hedging, so there's something on hedging, so I'd better go look at that and figure out what's going on with hedging. With capital rules, that affects everybody. So there's always webinars, so many educational opportunities you can hardly stand it – I went to a CFO conference last month, and of the seven speakers, three spoke on the capital standards. So there's a lot of educational opportunities – probably more so. But again, that goes to what's the cost of compliance and following the rules. And is having an extra – having more methodology to calculate risk-based capital, which is one of the things that's in there – is that really going to help the banks' overall condition. Maybe? It's debatable.

Showing our compliance officer does well and staying in tune, keeping us informed, every week we have, for example, on Monday, we have officers loan committee, usually one of those meetings, she'll come in and say, here's what's coming up, here's what you need to be aware of – she communicates very regularly with the regulators on the compliance side. If we're developing a new product or have a lending question – she'll say, we got told this, what's your opinion? And she'll bring that back to the loan officers that are kind of on the front line.

One thing we've done here – that other banks have probably done – we've centralized all of our loan document preparation. So instead of having a loan assistant at every banking center, we have three or four ladies and a couple of gentlemen, I guess, in Purcell, that are all centralized, and they prepare loan documents. They file the collateral. They do all of the backroom stuff to prepare those documents. And so, because you have a centralized group doing it all the time, you have a lot less room for error than if you have twenty loan assistants or loan officers that are trying to do it this way. They specialize in it. They know more about the lending rules and Shelby's in that same area with them – and she'll sit with them and interact with them quite a bit as far as, this is what we've got to do.

We rely on our vendors. Our loan software vendor that prepares all of our documents – there's certain – they actually have insurance that they will meet the compliance rules, so their documents are always changing, they're always doing updates. There's a lot of stops that ensure we do the best that we can.

Software has really helped.

How involved – the operational/strategic decision making – how involved is she or compliance – in those decisions?

Pretty involved. She's got the personality to be pretty involved. She is – like for example, we have a product unit that develops our products and services. So if we do a banking channel for a

mobile banking app, she's involved in that committee that helps design how it is implemented. So we bring her in from the start. We redid our entire deposit product offering. Well, from the brochures to the interest that's paid to everything – she reviewed everything before it got approved and ready to be rolled out. And so, she tends to sometimes be a bottle neck, which irritates some people – but we'd rather do it right than have to redo it later.

Of course, our marketing people are saying, they're doing this, why can't we? Well, it's not right.

About the interaction: What are your points of contact?

Probably – I mean, it really depends on the bank's condition. For example, three years ago, we had some asset quality issues that had to be cleaned up like many other banks did. So we got to communicate with them at least quarterly – because they wanted quarterly updates – what are your financials? What are the key ratios? One of our things was to improve our earnings – so they wanted to know what steps were we taking in our earnings. So we were meeting – not with them – but as an executive team, weekly for a little while, to talk about what we could do to reduce our expenses and to increase our earnings. So, and then we would report back to the regulators quarterly and say, here's this test we took for the last quarter. Here's things we're looking at improving. Here's things that will help. But now that things are more normalized, we're really not on the safety and soundness side – probably not communicating that much. In fact, because of our last exam was really good, they're going to come in – normally they were coming in every year – now they're coming in every 18 months. For a formal visit. If we have issues that come up – like when we redid the product offerings. Obviously Shelby communicated with – there's one who was like, can we do it this way? And so she communicated with the compliance regulator – so it's more on an as needed basis. And probably – if that happens quarterly, I'd be surprised.

So you've got contact initiated by the regulators, contact that's initiated by you?

That's true. We do get contacted by the regulators from time to time. If they see something on our numbers – what's this large – because everything is an open book – what's this large recovery you have on this loan? Well, that was on this loan that we charged out two years ago, here's why. It's kind of like a little Q&A thing. Or if there's – last year, there was a couple of times – there were some credit card breaches – last year and a couple of years ago – credit card breaches that were fairly large – so we get a contact from the Federal Reserve – did you know there were some credit card breaches? Is there any risk or credit risk at the bank for that?

Do you think you've gotten better at this relational side of the regulation game?

Yeah, I think so. I think so. Because, it used to be – you know – banks are very – way back, going back to my examining days – banks and examiners had a very adversarial role. When I first started – you called them on Friday and said, we'll be there Monday. And you'd show up with a group of ten people in a town of five hundred people – and say, here we are to examine you. And you try to tell a banker, as a young guy – you try to tell a banker who's been banking

for thirty years – this loan needs to be charged off, or you need to this or that – and he’s like, who are you?

And now I’m one of those guys who complains about the hot shot kids. But the it is – it used to be very – a lot of examiners many years ago, were very adversarial. Now, my perspective is that they are much more congenial – they’re not friendly – but they’re open to listening to you. The challenge is – as I mentioned earlier – what you tell a guy on site may not make it in a report, so someone from Kansas City might say, you can’t say it that way – you’ll have to kick them harder than you thought. So – the state guys have been great. Most of those a fair amount of seniority. They don’t have a lot of new staff at the state. The Fed is seeing a little bit of turnover with the recent changes in the economy – the regulators tend to hire when the economy kind of starts having issues. That brings in new staff, which can be a great opportunity twenty five years ago (for me).

How much input do you think you have in new rule creation?

We have an opportunity to provide comment. That might be a good way of saying it. Like on the overdraft privilege, we provided, Penny and I and others typed in comments and input and everything else, and talked to people about the rule. There’s a formal comment period with any rule that comes out. Basel III, I think I typed and sent in a comment. There’s a few others that I’ve commented on. Debit card interchange is another one.

Are you involved in lobbying?

I was on the OBA board for three years right when the economic crisis hit – 2008 through 2010 – something like that. So I got to go to Washington D.C., and I go every year to the capital here, at least once or twice, and lobby for different banking rules. And currently I’m on the government relations committee for the OBA. Some bankers, as you have found, are really vocal and not liking the regulators. And I’m not very vocal – I mean, they have issues and some challenges, but I don’t think the guys here are necessarily the ones that are creating the issues. So, and I think you’ve got to keep things in perspective and not make things personal, and some bankers, as you’ve found, they tend to take things personally. There’s just – they’re just paranoid. The politicians and others in Washington are – they get sucked in and drink the cool aid and everything else, but it’s not a big conspiracy to ruin our lives. If you feel that, get out of the market. Get out of the business.

Are good at influencing rules?

I mean, as an industry, I think we’re very good at it. I think, you know, especially during Dodd-Frank and the debit card interchange and too-big-to-fail, I think the industry leaders, as you have probably seen, two big industry groups – the ABA and the ICBA – that do not work well together. And so, to have a split message from one industry, it’s just stupid. I mean, it just drives me nuts. I’m not an ICBA fan because anything that affects any bank affects all banks. Somewhere. Because I do business with larger banks, larger upstream banks. So their costs go up, my costs go up. And people just don’t seem to grasp that concept. Its like, Oh well, the big

banks are my competitors, so I don't care what happens to them. And it's just like, really? They're your competitor and they could also be your partner.

I think banks need to get along well, and I think the industry as a whole – I mean, we do have an impact and people do listen because we have a lot of – I mean, a lot of congressmen and ladies – are bankers – or not bankers, but they're businessmen, and they've got to have bank loans and dealt with bankers – and not just ones that come up that take them to the country club and buy them dinner when they're up in Washington, but they're the ones who are in their homes, and they gave them a start or their parents a start. I think they recognize that bankers are trustworthy individuals – hey, they can call me up and ask my opinion if they want it. And we're influencers in the communities, so if we're not happy, we may voice that opinion when it comes election time, and we do. We had a number of banking organizations that created PACs and everything else over the past few years to voice that opinion in races that – Oklahoma has always been rural, pro-banking, pro-business. Well, other states are frustrated – this last year, basically a lot of smaller state associations formed a federal PAC, and they started trying to influence a lot of those other races. It's like, Friends for Banking, I think is the one. Roger Beverage was kind of involved in getting it started.

Lobbying – or advocacy for rule change – is issue specific? You don't go out there and shoot a shotgun ...

No. And that's why you need the ABA because there's so many rules coming out with Dodd-Frank, as a result of Dodd-Frank.

The reason you care about one and not the others?

If it doesn't impact the bottom line or something we do on a regular basis ...

Banks' different interests – does conflict happen, and how aware are you of other banks' interests?

I don't know if they would agree that I'm fairly in tune, but I mean – I think with the committee, there's probably about over thirty banks on there of different sizes. Everybody – there's not many wall flowers in that group – in the governance committee – and they tend to voice their opinions, which is good. There's one – and I actually got to meet on another issue with the state treasurer – and he told me he told me about something he tried to get changed, he got shot down by a lot of the large banks. As a community banks, I thought this would be perfect from us. One of the bankers from the larger banks – he brought it up at the governing committee and said, well, yeah, the state treasurer wanted to do this – and I said, Charlie, this would be good for community banks. And he said, why would this be good for community banks? We don't want all those deposits – we're flush with deposits. If you could find municipalities another option than putting their money in my bank – I'd be all for that. And he was, like, well I didn't think about it that way. And I said, yeah, you shot it down before it got a hearing.

The next time, he brought up something he didn't know much about, and I had just visited with a guy about – and I said, what about this? And he said, well, we need to look more at that, don't

we? We look at it a little bit differently. It's just a matter of – you can influence things, it's just about voicing your opinion. And being educated – if you don't know what you're talking about, keep your mouth shut. So I'll just listen and try to learn. If it isn't going to impact me or impact other banks like me.

You know, we have a CFO group – there's about 15 of us in banks around the state that aren't really competitors, but we share ideas all the time. Like, hey, did you know this is coming up for a vote? How do you report this stuff? Or, do you have a policy about this?

Boundary retraction? Do you tattle on other banks?

I have before. I don't remember what the specific thing was, however. I just remember seeing something they were doing, more in their numbers, and wondering, what is this? And so I called, basically, my regulator, and said 'how are they doing this?' and they said, yeah, we were wondering that, too. And that's all that was said. I mean, I don't know what came out of it. I don't know anything else. I just put it out there. It made me feel better that they had noticed. And it made him feel better – maybe it made them act on it.

Does that happen a lot?

It doesn't happen allot. It is (very collegial). You (competitors) don't like each other much at all – they still serve the community. They do a lot in the community. And as long as they're not breaking the law openly, they're usually going to get caught by other people before they get caught by us.

What about others outside the industry?

Mortgage lenders that are non-bank mortgage lenders. Credit unions, too. Farm credit. Because, you know, agencies that were set up as government, quasi-government agencies, to help certain markets. Well, good Lord. Oklahoma's got over two hundred banks, many of which are in farming communities. And then they create products that are not only – but they have lending products that are outside their normal – used to be like mortgage, fixed-rate lending – long term stuff that banks didn't really want to do. Then they have that product for them. Now they have lines of credit. You can get this, you can do all your lending needs right here. And then because it's a quasi government agency, there's no taxation. So they can do it at 3 percent where we've got to do it at 5. Credit unions: no real estate taxes, no sales taxes, no income taxes. Yeah, they should be able to offer a 2 percent car loan. Well, actually, we have a 2.49, but if you do auto debit, it's 1.99.

Is there any effort that you've made to throw barriers up to push back this mission creep of credit unions et al.?

I mean, the OBA – of course, is very vocal against credit unions. We as a bank – we have a lot of – we did it more on the one-on-one basis as far as telling the customers – we don't do a lot of consumer loans. We do some, but not a lot. And that's more of the credit union basis. Anytime we hear that the credit unions are trying to expand their commercial or business lending

authority, we tend to make comments and to call legislators – you really don't want to do this, unless you tax them. Let's make it a fair field. We'll not pay taxes – that'd be OK.

Most of my FDIC buddies – they all use credit unions because they can't bank where they regulate. So they go to the credit unions. And then, credit unions, they go in force. The NCUA is great at organizing thousands to go to Washington. It's like – I went up there one time for the ABA government relations – we had maybe 100 bankers. And they had 3000 credit union members. And it's just like – then you try to go see someone – and you stand at the back of a line full of credit union guys. Well, we represent the little people. I'm just like, yeah. Well.

Frame?

From a banker's point of view? In a dream world? Or what it is? I mean, our bank, we really would like to have more of a free market system. We want to have people to be able to make loans and make deposit decisions based on what's the best product or service for them. Yeah, give them disclosures, and not only disclosures – makes me think compliance and regulation – but give them the information to make that decision in a simple way. Our fee is X, their fee is X. Or we offer ATMs everywhere. And they offer it just in the state of Oklahoma. We'll provide the services – you make the decision. As far as offering – I think regulations have their role – obviously, you should drive on the certain side of the road, or drive the speed limit (roughly), but there's a lot of regulations – should there be rules about banks not disclosing customers' information? Yes. Should the government dictate the font size and the layout of that privacy notice? Probably a little bit much. There is definitely a role for regulation. I'm also a believer in the bible, and there's all kinds of rules and regulations in there, too.

Interview No. 10

What's your background?

My name is Ed Townsend. I've been in the banking business for 45 years. I went to the UT accounting program. I have a degree in economics. And I have a masters in financial accounting. Started with banking in first national bank in Dallas and moved up. ... I started a bank. We started this bank from scratch. Denovo. Brand new charter. I applied for a federal charter. I wasted so many millions – got the charter approved in four months – which is the record time for a federal charter. I've since gone to a state charter. Opened the doors in June of 2008. Bank of Groves -- \$121 million in assets, which is remarkable in a small community of this size. Grove is a fairly prosperous. I have something that is quite unusual in banking – I look at all of my major accounts – I have 1,167 accounts as of yesterday's balance sheet that average – these are checking accounts, money market accounts – not CDs – that average over \$51,000 average. That's incredible. In fact, I've been in this business for 45 years, and I've never seen anything like it.

It says that my customers – I'll tell you the key – we're the only locally owned bank in Grove. Number 2: you saw this building when you came in – and if you look at the environment – this is

not a typical bank building. The market appreciates a place to do business that they feel great coming in, you're welcome. Sit-down tellers. You walk in the lobby, and one of those ladies will recognize you, they'll call you by name. We're established. We build relationships.

His wife: Ed watches them as they come in, and they walk out and greet them – they've got the chairman and owner of the bank coming out and saying hello to them.

The point is, the movers of small business – when you run a large corporate company – 1,000 employees and thousands and thousands of customers, you can't really provide service to that extent – but if you look at people that I have observed that are very successful that start their own businesses. They are deeply involved in the process, and you have to recognize that to succeed in business, it's really simple: you've got to add value to your customer, and you've got to have people who appreciate what you do.

Stanly Marcus – of Neiman Marcus – used to say: my father always said to me, don't forget that in order for a good sale to exist, it must also be a good buy.

I do not like working for somebody else. I like to create my own business, and I've been CEO of companies since I was 37 years old. I've found myself as an intrapreneur in corporate straight jackets. When I was working in my younger days – I thought I had better ideas – that's a very frustrating feeling. So if you're an intrapreneur, the advice I give is to discover that area.

Wife: But all of your corporate training was very helpful in establishing the reputation that the regulators that allowed him to – they knew him as a person of integrity. They don't give out charters like that just to anybody.

You were a national charter originally – why switch?

I did because the state charter – I know the state banking commissioner Mick Thompson – he's more responsive to the needs of a state community bank. The office of the thrift supervision – became very bureaucratic and based on – I could pick up the phone and call the state banking commissioner. I've always run extraordinarily clean banks in my life. I've always worn the white hat. My banks are clean. I've never run a bank that's not clean.

Wife: Which was one of the reasons he was given the charter.

Office of Thrift Supervision – we had the OCC, which issued the national charter, and we had the office of Thrift Supervision, which issued savings bank charters. I started with that charter because my initial strategy was to be more of an investment-driven bank rather than a community driven bank. And the state banking commissioner is much more friendly for banks like what we're trying to do.

I'm not a federal reserve member. I do have a holding company because I wanted the ownership of the company in one place, and I distributed part of that to my daughters.

Relationships with the regulators:

Extremely well. We're state. And then we're examined by the state and the FDIC alternatively. The holding company is examined – the holding company is the only purpose to own the bank – and I did that of the distribution of ownership. I didn't want to distribute the bank stock. That's the reason for doing that.

We are a non-member bank.

First of all, Mick Thompson is a great banking commissioner. Dudley and those guys are very supportive and very helpful. I've had a longstanding relationship with – it is very constructive, but the banks have to be very respectful of the regulatory process for this reason: we have to understand that the reason why we operate is because we have FDIC insurance. Without insurance, I couldn't leverage 10x, so I put in one dollar of capital, I can get \$10 in assets. Well, that carries a level of responsibility. So I've never felt it was in any way an adversarial relationship with the regulators. In fact, my experience has been if I see a bank having adversarial relationship with the regulators, 95 percent of the time, it's the bank's fault. There's something wrong with a bank, or they're not doing what they should be. My culture: we will do things precisely as they are required to do them – it's a religion. I have a full time compliance officer. All that person does in a \$121 million bank – she makes sure we comply with every aspect of regulation; that we comply with every part of the bank secrecy act. And I am very respectful of that process. Our relationship with the FDIC is extraordinarily good. We had an exit interview two months ago – it was almost embarrassing how complimentary they were. It lasted 25 minutes. The exit with my competitor – the meeting lasted five hours, and it was not friendly. The bottom line is: we do what – I understand – I'll tell you – banking is the greatest, because the bank doesn't know when it's Monday or Sunday – if you've got positive interest income, it's earning 24 hours a day. And as long as you pay less interest than you receive. In our case, that's approaching \$4.5 million. It's a great business. So the process of being regulated is easy.

What proportion of your performance is influenced by the regulatory environment?

Well, I can tell you – the direct cost of regulation and everything I have to do with audits, outside audits, compliance person, costs me about \$100,000 a year. Everything. Five percent, minimum, of my profits are consumed by just that one aspect of that. If you look at this idiotic Dodd-Friedman, Dodd-Frank bill – I don't like Frank – take, for instance, the overdraft issue. If you overdraw our account using your ATM card, we are not allowed to charge you an overdraft fee. But if you overdraw by writing a check, we are. So you know what that does? It causes me not to give ATM cards to people that I think have marginal accounts. And so they lose the benefit of that. I mean – I have no choice because they create exposure. And we have to be compensated – we will lose some money in those cases. We've gone off overdraft charges – but if I can't get compensated, why should I give an ATM card? I had one person – they didn't want to open an account, but they wanted an ATM card. I said, you really have to have an account with an ATM card, we just don't give those out.

Opportunity costs –

I'm the kind of banker that stay in the cream of the market – and I'm very risk adverse. I wouldn't consider subprime lending or anything like that. So I really haven't felt that constrained from an opportunity stand point – because I really don't want to expand beyond a relationship with you – I'll finance your home; I'll finance your cars; I don't want to do exotic commercial vehicles. I don't like financing accounts receivables, inventory, and process. What is inventory and process worth? Nothing. I learned the lesson from retail in New York – a guy was 25 years old – he must have been a millionaire at the time – and he took me around his warehouse and he was with a wholesaler – he said, Mr. Townsend, let me show you why my business is less risky than a retail business. He pointed at a box – he would have 20 hats in there.

My issue with regulation is that they cause to spend so much effort just meeting those regulations that it probably keeps me from doing more of what I should be doing – serving my customers. And then, I would probably avoid some – you know, consumer lending is something that I try to avoid – I focus on a limited number of deals because the regulatory process here can be pretty burdensome. Maybe we would do more of that – but I haven't really felt it because it's not been in conflict with my conservative strategy that I use for this particular bank.

When I was running a \$10.5 billion bank, I would feel differently because I would leverage out more to other areas.

How do you know what's in the rule book?

Oh man. I don't. And I don't think anybody does, and I don't think the state bank commissioner does. You know, when Obamacare deal – the Affordable Health Act – it's like 2200 pages: the regulations that follow it are now, I've heard, 25,000 pages. The same thing is going to happen here – it becomes almost impossible to know. So we focus on the major issues. That's why I have a full time person that tries to stay up with how does it impact home lending, and those things. But it's almost impossible for anybody to keep up with any aspect of it. It's chaotic – it's ridiculous.

And yet you seem to be very good at conforming to regulatory expectations. How can you do that and not really know what the law is?

I know what the major law – its not that we don't know what we've got to do. But if you – seven books – now come on, who can keep up with that. Here's the issue: when you let in on a home, you've got to give certain disclosures and limits on what you can charge and all of those things. Of course, all of those major items, we are very much aware of. Bank secrecy act, we are very much aware of all of the issues. The critical issues – the banks have to incorporate it in their day-to-day operations. But if you go back here, and you try to sell this piece of real estate and it has this element in it, how can I get it done? You've got to go to the book and then read the regulation that applies to that particular transaction that you want to do. I mean – day-to-day business, I have to know how to do it. I have to know the policy on funds availability; all my disclosures; the period you have to set aside for somebody to change their minds – but if I have a transaction that is literally out of pattern, I have to go to the computers and check all the regs.

Is there a difference between what you understand a regulation to be and the way they enforce it?

There are occasions in – I would say – it happens at every institution – when they get a compliance exam that something is not meeting the expectation of the regulators. And for the most part, if it's not willful, the regulators – and the institution has a history of good compliance – then you can generally work those things out.

Have you ever been surprised by a regulator?

Not in any major way. I've been at this business for so long, I know if I'm doing something right or not.

How relevant are regulations?

I'm not conscious of regulation on a daily basis. After you do this for so long, it almost becomes second nature. My cashiers, though – they have to be – it's the way in which you design your processes – it becomes routine work. At my perspective, I'm looking at 6 months, 12 months, 18 months ahead.

The only shaping that you can do – I'll only do things as we are required to do. As banks, we really can't shape the regulatory environment.

What are the routines you use to be aware of regs?

If I make you decide to make you a home loan, I've got to give you good faith disclosures. I've got to comply with all the requirements. I can only charge you X numbers. Once I make it, I have to give you a rescission period in which you can change your mind. I've got to make sure you have flood insurance if you have to have it.

We use outside auditors – BXK – does our compliance. And whenever these issues come up, we also use them to train our people. We go through extensive training of our staff. Of our board. BSA – in particular – because BSA has huge criminal and cost implications, so we do a lot of that. But I have a person who I send to seminars and stay up with the Oklahoma banking association puts on these things that cover the major issues. It is a full time job, even for a \$121 million bank. We've got a full time person. And I've got a very, very knowledge person – high cost individual – to do that work. So it's constant.

Regulatory regime is about relationships – what are your points of contact?

Banks generally have an officer that is appointed by the FDIC that is responsible for that particular bank, and it changes from time to time. Our situation is someone out of Tulsa – I'm not sure exactly who it is at this point – but we make a point generally, if there are any issues that come up that look a little bit different than what they should, when we file our call report, I've always in the past called them. I called the state banking commissioner occasionally, hey, things are going well, and I've got this or that issue, you see our assets changed by this amount for this

reason. So I maintain a proactive – really the calls are more initiated by the bank than by the regulators in our case. That is not always the case – depending on if you’ve got a bank that’s in difficulties. In some cases, they’ll put a regulator on board. Absolutely. They’ll put a cease and desist order – they could have somebody inside the bank. And I’ve seen that happen.

You know, we are a minority bank – I was born in Brazil, so I’m Hispanic. My daughter is Hispanic. Russell Perry. David Durett & Chris Turner (First State Bank on Northwest Highway -- connection with Swicky).

Have you gotten better at maintaining relationships?

Yes, I have. I was a public company – I had shares – we sold the company for \$385 million – we paid \$183 million for it. As CEO, I’ve become proactive at doing that. I think it’s important for a CEO to have a relationship with the regulators. I’m a relationship builder anyway. I’ve found that when you have problems – you just let the regulators know, and 95 percent of the time, they’ll work with you very well. It’s not an adversarial – and these guys that are just trying to make a living – they are not the cause of the problem. It’s the idiots in Washington that are the cause of the problem.

Framing

Respectful, and knowledgeable that it is a required process. There is nothing wrong with regulation that is designed to create safety and soundness within the industry. The problem is the overreaction by naïve people who think you can solve a problem by adding books and books of constraint. The final result is to reduce the serve you can profitably and effectively provide to the customer because, if nothing else, it’s not only very costly, but it becomes a danger zone, almost, because you can slip and get fined big time. So you avoid those issues. It’s an attitude – it’s culture – culture defines attitude – and the culture is established the leader, the top. And you can’t have good culture if the CEO doesn’t have the right perspective – because that’s where it begins. And particularly in this case where the CEO and the owner are the same. Here, actively involved in the institution. The culture that I establish in that regard is – we will do what is right and what we’re required to do and we will maintain cordial relations and we look at the regulators as partners. That same culture then flows through different things – the way we treat our customers. We treat our customers and will provide the best service in the community. It starts with hiring. You hire people who fit in that culture. You come in the lobby and you see people laughing and you see customers coming up in here. We don’t start a bank from scratch and build it to \$121 million in eight years in a small community unless you meet the needs and you’re responsive and you do it right.

Wife: There’s a great desire to be good citizens as well.

Interview 10b

How do you know what’s the rule book?

To be honest with you, I have not looked at the 165 page reports they provide. We actually go through a compliance company – RBK – this is what is called a compliance masters group, and he is a speaker for OBA – so Maureen would be, Jack Holtzkenecht. He takes those reports from CFPB and breaks them down and makes them English. Then he provides training to us every two weeks. Other than that, it's too difficult for somebody to read through. And it's just me.

We do sign up for emails through the FDIC, and they will send us information. But I haven't found it as informative as Jack's points. Like I said, he puts it in terms that are understandable and kind of does away with the unnecessary stuff.

Your bank is very good at playing by the rules – which is funny because nobody really knows what the rules are. Are you ever surprised?

There have been small instances, but nothing major.

Are you surprised by how efficient this process is?

I'm not surprised because the interpretation the FDIC and the CFPB leave – they don't provide it in terms that you can read it and understand that's how it is. Every person interprets it differently. There's actually FDIC examiners that will tell you the same thing. And we also know that through – we've been regulated by the state, and they may say something differently, but thankfully, its not been major. But sometimes – an examiner comes in and they disagree with you, you can actually talk through it and they might see that there is room for different interpretations.

What is the role of experience? Do you have to experience an examination/enforcement before you really understand what the rule is?

Yes. Sometimes.

Does that cause problems?

It takes a lot of training, and different venues. We do learn a lot when examiners come, but for the most part, we've been lucky and learned what we needed to learn. And then, when they get here – for instance the regs that changed in 2010 – when they came, we were telling them how certain things should be. We were ahead of them. I'm not sure how it happened, but it was true. But also, when I came into compliance – I didn't really understand how all of this worked. I didn't understand how this was a rule, and the guidance, and proposals. And that's what gets me the most – when a rule has been finalized, and then a proposal on the same rule comes out. I feel comfortable with Jack and his compliance masters group. I don't know where I would be without him.

How do you incorporate rules into your day-to-day?

That's what, actually, we are going through right now. Since I've become the compliance officer. Since May, we've had a reg change to Reg Z, which went into effect on June 1. With Jack's

help, we had a group meeting every two weeks – he provides the training materials for us, minutes for our board, upper management update, and as I get familiar and am quite sure on those, then I send it to our board of directors as a training session for them. And then we have a loan compliance meeting, and I handle the training. With the new regulations that are kind of – we’re working on right now. They’re pretty major. So I haven’t figured out exactly how I’m going to handle these. And RBK is actually coming in in August and helping us with two of the major changes that are happening. These will affect how we do loans. We do a lot of balloon loans, and they are making it almost impossible for banks to do that. The ability to repay rules – it’s just very – it’s scary. Thankfully, we have until January to be in compliance. But we are working on it now. I feel like the other ones that are coming down – like we have to provide an appraisal to a customer three days before closing. There’s actually some more changes coming this fall on HUD and how we disclose fees to customers and how we put the fees in our systems to affect the APR. And if these are over a certain percentage, then you have this type of loan, and then you have to do this other stuff.

For instance, with Reg B, certain aspects of Reg B are only compliant on consumer loans and another aspect of it is on all loans. Same thing with Reg Z and Reg X. And thankfully, they have been mainly created by Jack. I’ve gone in and added some stuff.

We have loan committee, loan compliance meetings. Internal audits. Every committee and audit committee is different. But as far as loans – everybody is involved. We’re still small, but we’re growing at a rapid rate. But you’re not going to be successful if your loan officers don’t know what’s going on. Fair lending – every person in the bank receives that type of training.

Training is regular?

There are certain regs that require regular training.

Interview 11

Background?

I was going to OSU and – just to give you a quick history – I was living in Morrison. You know where Morrison is? My wife was a teacher, and she was required – being a teacher at that time, you had to live in the school district. So we moved to the school district. Had a little bitty bank. Just absolutely small bank. Which was Citizen’s State Bank, which has two branches now in Stillwater. And now, the banker there was acquainted with me because I was active in the community, and asked me to go and work for him. At that time, I had no businesses course, no financing courses, I was going to be a psychologist. So I explained to him that I had no background whatsoever, and he says, fine, that way I teach you the way I want you taught. And so, I went to work there, worked there for about 3, 3.5 years – Stillwater National came calling. So I went to work for Stillwater National. I spent about 2.5 years there. Then, my previous boss in Morrison called me up one day and says, “I want to come by and see you on a Sunday afternoon,” which was highly unusual. So he drove down to Stillwater and told me that he was

buying a bank in Holdenville and he wanted me to become president and CEO of that bank. I said, ‘Why? I’m 28/29 years old?’ – I’ve had six years of the banking business. And I probably don’t know what I’m doing, but I think I do. And so, I went to Holdenville and was there for about 17 years and – and for a couple of years I did some consulting – then about 18 years ago, I came here. I’ve been here ever since.

In the same capacity?

Yeah. My first six years was employee, assistant vice president, vice president, and then my last 39 have been as CEOs.

Shawnee bank started in 1984. If you were going to charter a bank and figure out when the worst time that it would be to charter a bank, it would have been 1984. And so the bank was chartered in 1984, was filled up with loan participations we had up in an Oklahoma City bank. Bought part of loans from an Oklahoma City bank. That bank got into trouble during the 1980s. And a lot of their loans were not good. And so, this bank had bought a lot of those loans, and so this bank got into financial difficulties. The charter and the original owners of the bank were local guys who wanted to charter a bank, and they wanted to own it. And they did. Now that they had it, they didn’t know what to do with it because of the challenges that were out there. At that point, they went to the Citizen Pottawatomoni Nation. One of the board members lived across the street from the chairman of the tribe – and they went and asked, would you all have an interest? And so the bought controlling interest in 1988. In 1994, the opportunity to sell presented itself, and the tribe went ahead and purchased 100 percent of the bank, so they have 100 percent ownership of this bank.

Why national over state?

Frankly, all of my 40 plus years have all been under the national bank – except for the 3 years in Morrison. But I have observed, over the years. Regulators go through cycles. So those state banks that are regulated by FDIC and the state banking department, or a state bank will be regulated by the state banking department and the Federal Reserve, depending on the situation. The Federal regulators historically, whether it was the FDIC, OCC, or the Federal Reserve, are more challenging to deal with. Why is that? My observation and my believe is that the state banking department – most of the examiners have been here in Oklahoma, grew up in Oklahoma, know the Oklahoma way of doing things. They are more familiar with their bankers. They don’t have turnover, or go to Dallas to Washington. Or from Kansas City to Washington. So you’ve got a little more continuity. Sometimes the state banking department is given credit for being more realistic. I don’t know if that’s the case. I’ve always had good relationships with national bank examiners. Has there been a time when I didn’t want to pop somebody’s head off? Yeah. Don’t put that in there.

But overall, my experience with regulators have been fairly positive. In the 80s – the regulatory environment in Oklahoma, Texas and Louisiana, where the perfect storm took place. Commercial real estate, agriculture, energy, all went to hell in a handbasket at the same time. And so banks were failing right and left. Some would say that part of that was caused by the heavy handedness of the regulators. And in some cases, I would probably say that as well. So

Generally, too, with the local regulators from the Feds, they generally come and stay as well. They are – and you are able to develop a relationship. Now, when I say ‘develop a relationship,’ does that mean they’re going to cut you some slack? No. But at least you’re able to sit down and have a discussion and be able to have a hearing.

More and more national charter banks making the switch ...

With First National Bank? I would say that’s something you always keep at the back of the mind. You’re not – at some point, you’ve got to make some type of a business decision. Whether it warrants going ahead and making a charter – but we would probably save five to 10 thousand a month if we switched over.

Probably be a financial decision.

Who are your regulators?

We are subject to the OCC. (No FDIC). The CFPB hasn’t filtered down to us yet, and I’m extremely thankful.

How would you characterize your relationship with the OCC?

With us, I think it’s very good. And even – you know – we’ve known them for a long time. They know us. We know them. Again, just because we know each other doesn’t cut us any slack whatsoever, but I think if they tell me something, I know enough to know whether that’s correct. If I tell them something, I think they know that as well, too.

What’s your compliance mechanism?

I ultimately have that. For example, the OCC calls each CEO on a quarterly basis and after they get our UBPR – our uniform bank performance report – they take a look at that and see if there’s any variances that they have questions about. So they’ll call up and want to talk about the variances. They’ll want to talk about any new products or services that you may want to start giving out – not giving out – but selling to customers. They want to know what our loan activity has been. If we’re doing anything in the loan area that historically we have not done, and we may not have the knowledge, they want to know that. They want to know how the audits are going. They want to know about personnel – have we had any changes in senior management. Those are some of the things that are going on.

What portion of performance is related to regulation?

On the income side – or on the expense side? (Both.) Some of the things that I have seen that have caused problems – and this would be a problem, whether you were a national bank or a state bank. One thing is, our overdraft fees have dropped off dramatically. And that’s because the customer has to opt in, so to go – the costs to go out and visiting with a customer and saying, here’s what we perceive as the pros for having overdraft, here’s what we perceive as being negative, so you need to take a look at this – if you feel like this is something that is worth the

price you're going to pay if you have overdraft protection, then you need to opt in. If you don't, well, just forget about it. So that changed overnight. Some banks have done a very good job of calling all of their customers and getting them to – getting an opportunity to explain to them why the overdraft protection is good for them. You know, we may charge them an overdraft fee, or the vendor can charge them a fee, the DA can charge them a fee. In the long run, our \$25 is much cheaper, but the Federal government in its infinite wisdom has decided something differently. So that's one area.

I've got several of my small western Oklahoma banking buddies that are saying – we are no longer going to give real estate loans. We don't have the capability – of escrowing the funds – of complying with the rules that are coming down. So I've said, hey there isn't going to be anybody in your community that does those types of things, and he said, that's right.

So there are several products and services that are affected. That affects income. Those areas that affect expenses – we have a compliance person, a compliance officer. We have an external auditor who comes in and checks on those aspects of it. We have, what we call an outside internal auditor who comes in and does - -generally on a monthly basis to make sure we do everything. We have internal auditors who – well, we have external auditors who come in and do compliance audits. Then we have loan review people who come in. So the cost – I have never sat down to make that determination, but I would guess that the cost for this small bank is probably \$300,000 to \$500,000 a year, just on the expense side. That we would do things differently if we didn't have that.

Has that changed significantly?

Yes. Yes. For example. And I know that there are some banks that are – but the large majority, and especially the community banks, realizes that if you don't take care of your customer or if you intentionally cheat that customer (or unintentionally) the reputational risk is already going to kill you. So you live and die by your reputation in a community. And so, when we used to do home loans, when I first got started in the business – we had a promissory note, a mortgage, and we required a title policy, and we required insurance. And now, how thick it is for a home loan is probably a quarter to a half-inch thick that they have to sign.

How do you know what's in the rule book?

What makes you think we do?

I'm getting that idea.

It is extremely difficult. And so what you have to do is you have to take it in bites. And you've got one person who's the expert over here – well, who is the 'proposed' expert – and you've got another for this group and that group. Even with that being said, they have other things they have to do as a banker. And to keep up with that is just absolutely mindboggling. That's one of the reasons that we have so many audits and so many exams and so many people looking over that to make sure – if we don't, we'll have to lock the door. There's a lot of those laws that are

obviously – even if there’s obviously no intent to circumvent or to hurt anybody, you don’t get do overs.

Rely on the OBA? Other external sources?

Very much. I would say every small community bank that doesn’t have a staff of attorneys – I would say most, if not all, will utilize those services.

How much of your time is spent reading the actual law?

Well, being the CEO – I can pass that along. Which I do. For a lay person – a non attorney – reading the actual law is tough at best. And so, you really have to spend most of your time utilizing third parties to do that for you. Now, does that mean that you don’t do that? No, some of my compliance people will sit down and read the laws. If their interpretation is the same as the ABA or the OBA, and in most cases, it is. But again, with the thought that there are no do-overs, you better make sure verify those things.

Take the Fair Lending Act. How does your bank handle that – you might have a compliance officer who organizes training.

Well, you have to set up some parameters and put some procedures in place. Your compliance people and your lenders have to sit down and develop that. And hope like that you don’t have – UDAP – unintended disparity AP – I mean, what you did you didn’t intend for that to harm anybody, but it may have harmed somebody ten rows down, and so, it’s just gotten so ridiculous – it’s unimaginable sometimes.

Would you characterize any of the regulations – or the enforcement of the regulations – as vague or unclear?

No – when the regulators decide to enforce it, it’s very clear. And you better listen and you better take notes. Yes, for the obvious reasons that a regulation doesn’t give you – or a procedure – or a policy – does not give you every possible scenario. And I relay this – I’ve done some strategic planning for another organization here a while back – and whether our strategic planning process, they talked about the third-party that came in that helped us and came in. They talked about the commander’s intent. Back in World War II, on D-Day, the largest battle that there’s ever been in the World – was planned out with extreme detail. They ran gasoline lines and oil lines from England to France so that all of the ships and everything and airplanes could have adequate fuel. So they have – the regiment had a plan – and the company had a plan – the platoon had a plan – the squad had a plan. They had plan after plan after plan. And if this plan went wrong, then each one of those entities had a plan to handle that. And what they found out in World War II is once the battle begins, all those plans went to hell in a handbasket. And so, what they wanted to do – the Army developed, and I think they still use this – what was the commanders intent. So the commanders intent was to take this hill or take this ship or take this whatever. And then, when their initial plan went awry, each commander knew what the intent was and started making decisions and making commands trying to figure out how to get to the commander’s intent.

So, with that being said, with all those policies and regulations, you can't use commander's intent. Even though you think you know what needs to be done, there's always somebody there second-guessing you. So although that law doesn't address every issue, that policy doesn't address every issue, and the procedure doesn't address every issue, you still have to be right. Regulators are historians. They make a list of what has happened.

Materiality?

I don't know if the OCC nitpicks you as much as it is their perception of what the law says and what they're held accountable for is what their perception is – it's CYA. And, you know, this is what they've been told, this is what came down from Washington, to Dallas, to Oklahoma City and down into the field. So I don't know how much discretion they have when they're in a bank.

Conform to the intent – are you ever surprised by your conformance and what the regulators say when they come in?

Yes. It doesn't happen a lot because anytime there's a change, we start doing quite a bit of research, and a lot of times, what we will do is we will call regulators and say: this is how we interpret this. Are we going down the proper path? And a regulator historically has been trained to say, well, we're not going to tell you how to do this. So for example, there are loans from time to time you get a loan that you really would like to make, but it doesn't come in compliance – not compliance compliance, but strictly from a safety and soundness perspective – it really has a lot of hair on it, but you feel like the individual that's involved is of good character, has a good business plan, he may not have a bunch of capital, this may be a fairly new business – you just go down the risks that are out there – and we've analyzed the risk, and we feel we understand what the risks are and that we want to do this anyway. A lot of times, we think, well, if we do it, an examiner's going to come in, they're going to classify it, they may charge off part of it, they may cause us to have to reserve (loan loss reserve), all that stuff affects our bottom line. So sometimes, we'll call up the examiners and say, what do you think? When you come in here, what are you going to look at it? They'll say, we can't tell you whether to make it or not. So finally, you get to the point where you don't tell them. If it's a little bit risky, and you make that decision about whether you're going to make it or not and you just face the consequences.

In all honesty, I understand where they're coming from. They don't want to walk in here, and the loan's gone bad, and they don't want us to say, well, you told us to do this.

How fore-to-mind is the regulatory environment when releasing new products and services?

Yes. And any product or service our officers come up with goes up to the senior executive officers, and we look at it. It also goes to compliance. It also goes to the auditors. And it just goes on and on. And honestly, the cost just continues to go up just to do your R&D.

How have you gotten better, or first National being aware of what the regulation is?

I don't know that we have gotten better. I think we all have always done a pretty good job, but with that being said, it's easier to get better when there's three sets of rules – it's easier to comply with three sets of rules instead of 3,000 rules. It's become more complex. And we work it harder. And we spend more time. I always thought back in the good old days, where we never had any compliance issues – there wasn't anything to comply with. We just went and took care of our customer. The other side of it is, I look at the most regulated industry in the United States is the banking industry – second most regulated would probably be – I'm guessing – is the medical profession. And it comes to my mind that the legislature and maybe to some degree the consumer – but the legislature and the politicians – their priority No. 1 is the financial services versus healthcare and health services. That's one thing that receives the most attention, and unfortunately, the banking industry as a whole is the one where this is looked at. All this shadow banking stuff – it's been left to fall through the ...

You talk about the relationship that you develop overtime ... the points of contact – what are they?

Well, on a quarterly basis, a telephone call. And then once every two years, the OCC historically has had a CEO meeting, and so they have the folks up from Dallas, and we sit there and talk about banking issues and what their hot buttons are and what we could expect to come down the pike. So they initiate that. After the exam – and there are issues they want us to address – there's either telephone calls or emails. The OCC also has a directors meeting each year, generally in Oklahoma, they have them nationwide, that they initiate so that the directors have some understanding or feeling about what the occ is talking about. I go to Washington on a regular basis, as part of the OBA, and we go to the OCC and visit with them. Since we are a minority owned depository institution, every two years the FDIC, Federal Reserve, the CSBS, and the OCC has a big session inviting all the minority owned financial institutions, and so I think that's every couple of years as well. I try to go to that. So that's – try to keep really abreast of what the regulators are thinking and doing.

What are the differences between what you do and what the average banker does in terms of the relationship.

I'll tell you a story. Back in the early 80s, I had never ever had a problem with regulators. The bank was well run, well managed, never did have a problem loan, had good relationships, and we just did what we needed to do to make money and take care of our customers and do it legally. I'm trying to remember – Penn Square failed July 5, 1981 – my next exam was February of 1982, the examiners walk in, they go upstairs to our room. They get there at 9 in the morning, and I walk up to introduce myself to the examiners. They're there on a Monday morning, so I released myself to get the pleasantries in place and gather information for them. I tell them, well tomorrow is my regular board meeting – I've got board members coming in from all over the state, and I know you're going to want to visit with the board, so if you gave me a rough idea of when you want to do that, I cancel my meeting and they can just meet with you guys. The regulator says, and I quote: "You might as well go ahead and have the meeting tomorrow with the board, because your next board meeting will be in Dallas." Now, anytime the board has to go to Dallas, you're in deep doo-doo. They're going down there to be chastised. He'd been there 15 minutes and hadn't looked at a single thing, but his mind was already made up that there was a

problem. And lo and behold, before the exam was over, our next meeting was held in Dallas. So we went down and were chastised – they put banks on memorandas of understanding. Generally, those MOUs will last anywhere from 12 months to 2 years. If you're extremely fortunate, you get off in 12 months. It 6 months, we were off our MOU. 30 days after we're off the MOU, the Federal Reserve comes into the bank to exam the holding company, and comes to my office, and says, boy, there must be something wrong here – it says here that you were on a MOU. I said I was. He said, why? I said, to this day, I don't know. He said, you went on and off in 6 months. That never happens.

So in the 1980s, the relationships between bankers and the regulators was absolutely abysmal. It was – the regulators felt like every banker was dumb and was a crook. And because of that, we bankers did not feel very kindly towards them as well. So during that period of time, I learned that if you get into a pissing contest with a regulator, they can piss longer and harder than you can. And if they get tired of pissing, they'll bring in the reserves while you're still standing there trying to get a stream going. So with that, I made a conscious decision to make sure I have a relationship with them. I'll do my darndest to try to do what they asked me to do – if I disagree vehemently, I'll try to sit down and work it out.

Does that old attitude still exist?

I have heard comments that it does. My observation has not been so much that because – in Oklahoma – most of the banks in Oklahoma are rated 1s and 2s. So when it really gets adversarial is when those attitudes develop. And if, you know, if you're a 4 or a 5 rated bank, you're teetering. And so, the regulators – my observation has been, if you're a 4 or 5 rated bank, they don't give you a whole lot of time before you have to rectify the problems and salvage anything. But in Oklahoma, we only have had 4 banks fail since 2009, maybe. And the rumor is three of those failed because of fraud.

Do you see faces / or is it a faceless agency?

I see faces. I've dealt with the IRS and the IRS just takes it to a completely different level.

An inverse relationship between the hostility of regulators and the amount of regulation?

My observation would be that if you went to the individual examiner who comes into banks and does exams, that they're response is, we don't know how in the hell you're going to do this – there's so much regulation. We as regulators are struggling with this. So they are struggling mightily because of the volume and trying to figure out what is right and what is wrong.

And I would even guess that even all the way up to DC, there is some of that going on. Or a lot of that. They've been given a mandate by congress that is just absolutely mind boggling to them as well as to us. And they're trying to figure out how to do it – they don't like to go to capital hill and have a senator or a representative start chewing on them. And their bosses don't either.

Have you been able to loosen a constraint?

We try – if we’re trying a new product or service or trying to help somebody and we come up against a road block, we try to figure out, well, if I can’t do it that way, can we do it this way or that way? And so we try to legally find our way around it.

(On Lobbying). Oh. Tremendously. I’m a past president of the Oklahoma Bankers Association, and I started going to Washington DC to effect legislation back in the 1970s. And I go there and I served on the American Bankers Association Political Action Committee. And so – and also, when the ABA and the OBA sends out a missive as to we need your support for this particular bill – the last one I got was last week about credit unions and the tax exempt status – and that goes out to my employees as well – asking them to send letters and emails to representatives. To our two U.S. senators and our representative. For the most part, the state legislature are pretty well attuned to banking issues and they have some really good knowledge. They also have a close relationship with their local bankers. And so the local banker and the state rep may have coffee on Saturday morning to discuss issues. And for the most part, the Oklahoma congressional delegation – they have real close ties with the bankers in the state. Now, you get to California or Massachusetts, and it’s different. I look at the state house – the state legislature – and I see more of a difference between urban and rural than I see from Democrat to Republican.

Have there been any successes at loosening?

There have been a number of successes. The ABA, from a Federal level, has done an amazing job. The OBA has done so statewide. One of the things the OBA has done on numerous occasions, particularly right after I got into – about the time I got into the banking business – they had the uniform commercial code, and the uniform commercial credit code that was developed for the lending industry – the banking industry – which also flowed to the shadow bankers as well. They developed a code that would benefit the consumers as well as not be so onerous with banks. And they worked hand-in-hand with the legislature to do that. That piece of legislation has held true for the last forty years. Some of the other things that take place – there are – from a state standpoint – there are numerous occasions during a legislative session where some entity wants to have a law passed that will help them. One I can think of is the tow-truck operators – and all they’re looking at is from the standpoint, here’s how this is going to affect me, and then they introduce legislation, and the bankers, say oh my gosh, here’s what it’s going to do to us. So the OBA, along with the bankers, will sit down with that industry and say, lets see if there’s something we can do to solve your problem that won’t be egregious to us.

This happens at every legislative session at the state level – killing more legislation rather than introducing legislation. Now, on the congressional level, there are very few times that I can think of that the senators and the congressional delegation has not – we haven’t been able to sit down and come to some type of compromise that they can live with and we can, too. It’s incumbent upon us to try to take care of them and take care of the constituency.

How about constraining?

Of course, our big focus right now is credit unions. It’s been credit unions for 30+ years. Since I’ve been in the business. Credit unions are very successful in their lobbying efforts. Most of the legislators in DC bank with their credit union at the capital. I don’t know that we’ve been

particularly successful. We've been successful in some areas, but that's still a work in progress. Eventually, it will happen, because it just does not make sense to give them a tax exempt status. Now, there are other areas that we've made some headway, and it's on those mortgage brokers that were out there. The CFPB, if they will concentrate on shadow banking, that's going to solve a lot of problems. Because those of us who are regulated on a day-to-day basis, not a 12 or 18-month basis, we're not out there doing those types of things.

Do you guys tattle on each other?

I have never done that. Now, I've wanted to. Because I see them doing some real crazy things or things that I consider to be improper. I figure that when the regulators come in, they'll see it and take care of it. And if they don't, they'll wind up getting their button cracked somewhere.

What's your bank's attitude toward regulation?

We talk about this with our folks frequently. And those who have some grey hair and have been in the business for a while realize that – and that's our management team – that's the way its going to be, and that's the way it's always going to be. If you get up there and joust with windmills, you're not going to survive. It is what it is. Let's figure out how to do it right. Let's figure out how to work with it. Let's go home at night and be able to lay our head on the pillow and go to sleep. We might not be able to go to sleep out of worry of the next thing, but it won't be because we're doing something wrong and we're worried that they're going to catch us. My people realize that they just can't do anything improper.

Interview 12

What's your background

In 1992, I'd been working for banks – 1992, I started working full time in my own company. The idea was to – banks need a certain set of knowledge, and it's expensive to hire somebody with that, whether it's compliance, or internal audit, or whatever, the expertise is fairly expensive. Smaller banks really have a lot of trouble cost-justifying – it makes sense and in the early 90s, a lot of banks were realizing that it's OK to have somebody come in from the outside and help you out. Part of that, they really felt uncomfortable with – back in the 80s – anybody who wasn't an employee or under their umbrella looking at some of their documents. I look at board of directors minutes, payroll records, and all kinds of stuff. Some of the most intimate parts of their operation. But that was scary to them. But at that point, they decided that maybe we could be real careful and have somebody help us.

What is the philosophy you bring into banks?

The important thing is to develop systems that will be repeated over and over again. And it's not a matter of – you don't want people to have to think about what are the regs, what do I have to do when something comes up? Do you want to build a system and a set of procedures so that they are just doing the same thing. And then you've got to make some changes when regulations change. That's basically what I do – is help them install procedures. And the other thing, you've

got to have somebody who looks at what they're doing periodically. There's things – you can hire new people who, for instance, came from a place where they were trying, and it wasn't good. You can have changes in the regulation. You can have people who – one of the worst things is people think, we shouldn't be doing this. And they are right. But efficiency is not part of bank regulation. I mean, that's the other side. So they are more efficient and maybe even better customer service, but it's in violation of some regulations. They've done something they think is smart and good and they're proud of it, but unfortunately, it's not something that they can do. It's important to have somebody to come in who really knows what's going on. Believe me, stay on top of this stuff is several hours a week, just reading all the new stuff. And go to all the seminars – I do at least 40 hours of CE a year. To keep on top of this stuff. Even then, I get surprised. You never know.

Anyway, I have these checklists and these procedures that I use. Then my personal knowledge. I come in basically, what I do is I do kind of do what bank examiners do. Looking at this. But I do it from the bank's perspective and not from the "I'm going to catch you doing something wrong," which is the examiner's perspective. I understand there's things that are a concern to the banks that the examiners don't necessarily worry so much about. For instance, class action lawsuits – if you violate consumer regs and you're doing it on a systemic basis, you're open to a class action lawsuit. Which to me, is a much bigger worry than some examiner getting a little upset about something. And I'm looking at – and I have found those, you know, where they're doing stuff that could get them in big trouble. So that's kind of my job that I do. It's worked out well.

Are there banks that use you as their compliance department, or are there banks that use you as a stop gap?

I don't really think it's possible for me do compliance for a bank.

You need somebody there every day to make sure things are done right. But those people can't evaluate themselves. Now, you can't proofread your own stuff and do a very good job of it. You can do it, but it's hard to really evaluate your own performance. You think you're doing everything right, but something's snuck by you. So what I do is I help them adjust to changes and implement new procedures. Alright – if I see something the bank examiners are – I see something bank examiners are looking at or focusing on, then I let them know ahead of time, hey this is a new hot area – fair lending, or whatever – we need to make sure you're ready for them. And to the extent I can, I save them from being caught by surprise. That's one of the things that bank examiners do is they'll decide, OK, let's start looking at community reinvestment act or fair lending – and they don't announce, hey, this is now our new emphasis. You find out by hearing the horrible things that happened to somebody else. So I try to help my banks with that. But sometimes, they will still get caught. They might be one of the early ones, so there's not enough warning.

Fair lending is a good example. When they decided they're really going to emphasize fair lending and push banks to implement stuff that really isn't in the regulations, but their interpretation requires you to do some stuff – they would come in and just beat them up. Threaten them with bringing in the U.S. attorney. Some people get fired because they're not

doing what the examiners invented. The new thing. It's like – you probably heard the story about the regulator who's talking about, we'll do what the Romans did, you walk in and the first five guys you see, put them up on a cross, and after that you don't have any trouble. That was actually the way Romans would conquer cities. There was a case where some regulator had a bunch of his people, and he used that example, and it got recorded. This is how you implement this. I think this was the EPA – but they all go to the same schools. If they crucify five banks, the word spreads like wildfire. Oh man, we've got a new deal here. They're interpreting this in a different way.

But for a while there, they went to the board really chewed out the board. The board doesn't like to be chewed out – those guys are not used to somebody talking to them mean, you know? So anyway, that's a good example. Hopefully, I can save them from that. I try to. One of my banks got nailed early on, when I didn't know about their new deal. Only one of them – not the rest of them.

How do banks keep up with the rules?

The Oklahoma Bankers' Association is really pretty good about that – about providing seminars about new reg changes and the ideas for procedures, how to implement them. There's a web site that I find very useful – it's BankersOnline.com – it is actually a national deal, but it's a local group that does it. A lady named Mary Beth Guard is head of that. She started that company and is affiliated – or at least consulting with – the OBA. And quite a nice lady.

Are there differences between good banks and bad banks in terms of knowing when rules change?

There are a few banks you'll run into that go out of their way to prick the examiners. Or deceiving the examiners. They think it's all ridiculous.

Even now?

Oh yeah. I don't do business with them. You try to identify them. Because eventually, they're going to get in trouble, and if I'm in the vicinity, I'm going to get in trouble too.

Having a compliance problem is not as bad as having one and lying about it. Or trying to cover it up. It's kind of like cheating on your taxes. You can get away with it. But if you ever get caught, it's really bad. Don't want that to happen. There's a few like that. Most of them are trying to do what's right, but they're also realizing that there's – how much money you have to spend on this. An they're trying to balance the budget with doing what's right. So there's a limit. Some of them will give a little too much emphasis to the budget. Trying to save money. They'll end up with problems. Some of them, frankly, spend too much on compliance. Part of that is they think – you know, part of their personal pride is they want to have an outstanding rating. Not a satisfactory – an outstanding. Well, an outstanding will cost you probably \$50,000 to \$100,000 a year additional expenses. And it doesn't get you anything as far as I'm concerned. A satisfactory rating will get you anything you want. Unsatisfactory – then they start pressuring you. They won't let you open a branch or acquire another bank or put an ATM somewhere.

And then, once you get an outstanding, then the pressure's on to keep that outstanding. If you lose that outstanding, heads are going to roll. Everybody's scared to death – then, once you get an outstanding, you never know. One examiner can give you an outstanding, and another examiner can come in and they don't give anybody an outstanding. You can't get one no matter what you do. But rarely do they give them an unsatisfactory. Most banks are satisfactory.

How much is on the banker's attitude? Is it all about attitude? Or are there actual things they try to do, but they're just not doing it good enough?

In a bank, there's a bunch of people. The senior management may have one attitude, but the person actually doing it may have a different attitude, you know? Sometimes, you run into banks that at the senior level, it's not worth their time to do compliance. Somebody else can take care of it. But then you get down to the actual compliance officer, and they have a lot of personal pride. They work real hard even though they aren't getting great pay or support. They just personally have to do it right. That's just the way they are. I like working with those people. I'd like to see management – senior management – at least be knowledgeable about the general staff and knowledgeable about what it takes to do well. Ultimately, if it doesn't go well, they end up paying a big price.

Let's say you've got two different banks: both are equally committed to compliance. One bank does it better than the other? What are the activities that that bank is doing different than the less good bank?

Hiring me is a good start. Having a consultant.

Are there banks that don't use consultants?

Yep. There are. And there are some banks like that that do pretty good. But those banks are examined at a different level. The bigger bank in town, boy, you've got to know everything. And by bigger, we're talking, maybe, over 100 million in assets. But there's other banks out there that are 20 to 40 million. Well, like the guy in Laverne. They have under 20 employees. And they cut them some slack. They just don't have the resources. So they try to help them. Rather than punitive, it's kind of a 'let me figure out how to help you do this.' There's some of that that goes on. The success is really in having somebody's who've been at it a while. You spend a little money to keep them trained. Send them to a seminar to stay up on stuff. And they're willing to read the stuff that's coming out – spend a little time every day reading this stuff. And they're willing to communicate well with the employees – at least well enough with the employees so that they know what they're supposed to do and what the negative aspects of not doing it are.

Do you see differences – back to the same two banks – the better banks have experience?

There's some banking certifications you can get.

Are those people better?

Oh yeah.

What about attorneys?

It'll certainly help in terms of reading and understanding the laws and regulations. That's important. But the key is implementing it. And then steering it. You've got to get the procedures in place and do them in such a way that they're easy to repeat over and over, and get people trained. Monitor it. The JD person probably would be in a bigger bank and be funneling this stuff to somebody else who actually implements it. They'll help them understand it – that's where they could come in.

Some of these regulations are really complex. But maybe 50 percent of it isn't even relevant to your bank because you're the wrong size or because you don't offer the products. Whatever. You've got to narrow it down to what's important to you. Your bank. Turn it into an easily repeated policy and procedure. Implement. Train people. And follow up on it regularly.

When a new rule comes down – what's the flow chart? How does that turn into a process?

New rules start off as proposals. They send that out – everybody sees it. If you have a problem with it, you get to comment on it. Nowadays, they get thousands of comments on these things. I mean, people are very defensive. They get lots of comments. And make modifications. Then it comes out as a final rule. Usually what they'll give you is some time – maybe several months – before it actually becomes effective. You can do it immediately, if you want, but you don't have to do it.

So you've got the final rule out there. That's where the OBA – there's various organizations that will put together seminars that you can go to that tells you what good procedures would be and how to implement it. You'll get sample forms and things you can use in your bank. So that's a good place to go. I go to a bunch of OBA stuff.

Where do banks get their own policies and procedures?

I don't see many banks sit down and write their own stuff. There's also a national organization out there on the Internet. I think it's called BankPolicies.com. If you go to bank policies – they literally have policies and procedures for everything in the bank – job descriptions, everything. But they're not free. By far. But you get it and you get it in the Word format, and then you put your name in and modify things and fix it the way you want to and so it's like 95 percent is done for you already. There's another – a group called Pringle – she's an attorney, Laura Pringle – she put together a – it's basically a policies book that you implement the policies and it's like a couple of 3-inch binders. I mean, it is serious stuff. Next to impossible to read.

I think it will work for some people because it is so much volume. My opinion on policies, board policies, is they should be as simple as possible. And you should know the difference between a policy and a procedure. And a lot of people don't. They'll just use the two words together. You think, after a while, it becomes one big word. And there's a big difference.

I'm a newbie: what is, for the record, a policy and a procedure?

A policy is a general statement of what the bank directors – it's a board policy – what the board of directors wants. What they expect. And it basically says, overall, what the concern of the policy is. It gives – assigns responsibilities to people – and it assigns ways to report back to the board that it's been accomplished. So it should be – and I always think when I'm doing a policy or looking at a policy – you don't want to put something in there that the board will have no earthly idea about whether it's happening. And then, that will become a tool – or a noose, actually – for the regulators, who will come in and say, here's your policy, and it says you're going to do this and you haven't been doing this for years. What's the deal?

Are policies attached to regulations?

They can be. There's a loan policy. A loan policy says what amount of loans you're interested in. Things that you don't want. Who's got the authority and the responsibilities – that's a long policy. But you might have a regulatory policy like truth in lending. And that talks about how you'll want to implement and make sure the regulation is in place. If you don't watch the examiners, they'll try to make policies into procedures. I don't know where they went, but they don't know the difference. You've got to be really careful. But if you do policies that are short and summary and get to the point and have all the components but don't get down into "so and so's going to do this" – stay out of the details – then you have to follow through with procedures. Then you have to say who's going to do it. Who's responsibility. Quite often, the board has the ability to ... there's other deals called guidelines, but those are kind of rare now.

Procedures are how the policy is implemented.

Exactly. It gets down into the daily activities. Who's responsible for doing this. What steps you'll follow. You can make it very detailed. It doesn't have to be very detailed.

What's the difference between a good and bad procedure? What gets you into trouble there?

A bad policy is either – it doesn't fully address the area that it's written for, or it goes into so much detail that it's going to end up being a problem for the board. Because this is the board's policies – they approve these things, they're actually supposed to read them. I promise you, you give a board a three-ring binder full of legalese, I don't think you could make them read it. Some of them will skim it, but they're not going to read it, then they're going to approve it, then they're going to be on the line. A board of directors – they're held responsible for everything that happens in the bank. Not only are they getting in trouble with the examiners, they are financially responsible. Based on your size and your capital and so forth, you can only make loans a certain size. If you go over that lending limit, the board can become the guarantor for that excess. They can be forced to pay if the limit is exceeded by a million dollars, the board gets to pay that million dollars. If you have a policy that is a consumer reg, and it is typically violated, they can assess civil penalties against the board members. Then, if the bank fails, they're going to sue half the board members. So there's financial liability that most board members don't appreciate.

Good procedure and bad procedure?

It could be too detailed. It needs to be written in clear, easy to read language. Not a lot of complex sentences. Not a lot of huge words. Procedures, the regular line people can have a copy of the procedure that relates to their job, and they should be able to read it and understand it. Be trained on it. It is almost like a recipe in a recipe book. Even though you might give five people the same recipe, stuff may not turn out exactly right. But if they didn't have a recipe book at all, it could turn out really bad. You've seen recipes where you're like, what on earth is that?

Two equal banks. Both eager to comply. Both have procedures in place. One bank is better at following its own procedures than others. What's the difference?

Probably turnover. Some banks have a lot of turnover. And everytime you have turnover, it's like a new day. So you get somebody new in, even though they go, I've worked at banks for ten years, and you say, Oh, great, this guy knows what he's doing. Well, did the other bank know what it was doing? He might be thoroughly trained at doing it wrong. So you've got to watch the new people really well. It becomes almost muscle memory. Know how to interact with customers. Know what not to say. That will be big part of it.

Support from the senior management. Here's where something important comes in. There is a conflict between customer service and complying with regulations. And those banks that emphasize – community banks in particular – really emphasize customer service. We want – if at all possible, we want to do what this person wants, you know? And they will bend over backwards to do that. So you have somebody, say, you have an internal control that requires two people to sign something, and the customer goes, I don't have time for that, I'm late for my appointment, but I need this now. So they will violate procedure to do customer service, and then try to cover it up later in some way. Get somebody to sign it. So that's a conflict, and I've never been able to totally resolve that.

Does that happen a lot?

It does. It is a significant problem. Because the regulations are anti-customer service. And the internal controls – some people, I've told them, look here, internal controls are your basic stuff you've got to be able to do. If a customer came in there and said, well, I don't have time for this – go in the vault and get what I need and let me get out of here. You're not going to let them do that. At least I hope you won't. That's not a good idea.

Sometimes, they do things that are just as bad that violate internal controls. For example, wire transfers. I know a bank that had a customer who was a doctor. Busy, busy, busy. He told them, I want to be able to call you or send you an email to do a wire transfer and I don't want you calling me back to confirm it. I don't have time for that. So you get an email, which anybody could send, it could even be with his signature at the bottom, and it looks great, you know? And you send that wire out, it's like handing money out the door – it's not coming back very easily. So, they got an email from the doctor, who wanted \$75,000 sent to Hong Kong. And they're like, Oh crap, we've got this doctor who says, don't call me. And we got a letter from him that says, don't call me. But still, the doctor doesn't send money to Hong Kong, and most of his wires are two or

three thousand at the most. This is a little suspicious. Customer service – he said, don't call him, he's busy. They sent the wire out. Internal controls – granted, we're not supposed to do this, but this is unusual, I think I need to get some confirmation. It's too big. It's going out of the country. I think we need to talk to him. Well, it was fake. And they could have forced him to take the hit, since he had told them not to call them. They took the hit, and the employee got fired. But she was doing what she had been told to do – but she should, at the very least, have gone and talked to the manager and said, you know, this is unusual.

You set dollar limits. There is bank discretion in that. If you call back and confirm it, you're much less likely to have a loss. So banks decide how much of a loss. They do have insurance, of course, but they usually start at \$25,000 and up from there. And even 25 thousand worth of deductible, the insurance policy will say, you have to do a call back. If you don't, you don't have any insurance.

I do transfers. It's one of the things I do. I pretty much insist that they pick a dollar amount – whatever they're comfortable with. If you don't do a callback, you'll eventually lose that money. Pick a dollar amount, pick an amount you're comfortable losing.

Are there differences between turnover and senior management support?

You go into a small town in Oklahoma and the best job in town for a person who may not have a high school diploma is at the bank. But sometimes, they don't pay much over minimum wage. So the turnover would be because the pay is smaller. Maybe if there's a competing bank in the town, then you get a little bit of stuff going there. If there's a grocery store, the store will hire them as cashiers. So if you don't have much competition, the wages are going to be very low.

And then there's – are you familiar with Bank First – big. I think they have 80 locations. It's huge. It has offices all over the place. And a lot of little towns. And they do some things really well. They allow a lot of autonomy. These local areas. They kind of got – from an operations standpoint – it's centralized – but from a lending, community involvement, it's more left to local communities. The Rainbolt guy, who's the head of it, I was at a talk he gave, and they were asking about his training budget, and he says, we don't do training. We just look around, find some other bank and hire their people. And he was proud of it. So if you're near a BancFirst, you're going to lose your employees. You get them all trained, and bam, there they go.

Back in the 70s. There was a gentlemen's agreement – you would not interview somebody who was currently working at another bank. If they wanted to interview with you, they would have to quit first.

How much is automated? Procedures?

Oh man, it is so automated. It's called platform system. And it's available for loans and all kinds of loans – mortgage loans, commercial loans. And it's a cool deal. Fairly intensive. But pretty much all the banks have it. So you sit down and input on the computer the application and what the guy's looking for and the computer spits out all the appropriate forms for that particular kind

of loan, and then it gives you a laundry list for what you have to do. And it ends up in a credit file some place.

Do you work with state and national banks? Are there differences?

Yep. I can give you my personal opinion. There's two banking – federal agencies, the FDIC and the OCC – and then there's the Federal Reserve bank. And they do state charter banks that are members of the Federal Reserve Bank. Because of their purposes, I think causes differences in how they interact with banks. The purpose of the FDIC, when you get down to it, is to protect the fund. The FDIC fund. That's like having your home insurance agent come out and look at your house and see if you're doing anything you shouldn't be doing that might catch it on fire. Look at this, your barbeque is too close to the house. We'll have to write you up. Also, they're very interested in consumer stuff. Consumer regs. They are pretty heavy handed when it comes to consumer stuff. Particularly if you're talking about fair lending, fair housing. They're one of the ones that just really crucify the bankers. And they get caught every once in a while going too far. They will just shoot out there and do something off the wall crazy.

The OCC. They seem to think they're to protect the overall banking community. Which would be the economy. The banks. They need to do a better job on the big banks. They can be pretty rough also. Safety and soundness exams. Fairly sophisticated. Well trained people. Most of them are personalities. I joke about – on their applications at the bottom is, do you have a personality disorder. If you put 'no,' you're out. Sorry, we gotta have that personality disorder. That's just one thing you can't train somebody for. No matter how much training you get – you just can't train it. It's a talent. Just gotta have it. Some of them are pretty good. I think they're smart. Pretty good. Rough as can be. If you get crossways with them, man, they'll yank your board down to Dallas and take them to the woodshed.

The Fed. They are actually – the Fed is run by the banks. Their objective is a smooth running financial system. For the country. They were interested in the consumer regs, but they're really more likely to help you – to help a bank comply. Figure out ways. Give them suggestions and alternatives. Teach them how to skin a cat. Even the big banks. They will do that with. They're much more likely to be like a consultant than an examiner. Unless, there is an unless – if you ever tell them you're going to do something, and you're lying about it, and they catch you, it's like – there's a big mark under your name that never goes away. You might as well change charters because you got thrown into the big bad guy category, and they look at their file every time before they come out to the bank, and the last file in there says, 'this guy won't do what he says, so you can't trust him.'

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What do you do?

What we do originally the company – a little bit of a background – the company started out as loan review, which has nothing to do with the regulatory side. It's more the credit quality. So we're kind of half and half – half loan review and half compliance. So on the compliance side,

that really started picking up in the early 1990s. They decided to kind of go off – I came on in 1999. And we've really grown it since then. Several reasons: a lot of the regulatory changes. The banks that have us come in, what we typically do is we just audit their real estate loans, their operational – like Reg CC and different things – we try to find the problems they have before the examiners come in. There are three regulatory agencies – the OCC, FDIC, and Fed – and all three of them are very very big proponents of the bank having audit. It doesn't have to be outside audit, but most of our community banks – cause our bread and butter are the smaller community banks – we work for some larger ones, but our main focus is our community banks. They're not going to have the people with the expertise or the time. Because everybody wears a lot of hats. So we come in, usually, we're in a bank three times a year, doing audit. A loan audit, an operations audit, and the BSA is another side. They use that to let them know what their problems are. The good banks, as you were talking about, will take our audits, figure out the root cause – that's a really big deal – and then fix it. So that those problems don't happen.

Usually, all through three of the regulatory agencies are pretty good – they want the banks to find their problem. If we go in and find a problem – even if it's a big problem – if the bank has corrected it by the time the agency comes in, they will not usually cite them for that. So that's where we come in. Very beneficial. If we find it and the bank corrects it, the examiners will not hold that against them. Now, if we find it, and the bank doesn't do anything about it, then it's almost worse. Because then, you knew you had a problem but you ignored it. Versus, we just didn't know.

Are there banks that ignore it?

Yeah. There are. I'd say 90 percent of our banks don't. Because you have to assume that if a bank is going to spend the money to have us come in, that they take this pretty seriously.

We've evolved, and we're really trying to evolve even more now, because there are all these changes. The banks are having to evolve as well. We've been offering more services – maybe a little more hands on at some of the banks. It just depends on what the bank wants us to do.

Kitchen nightmares question: what's your philosophy?

I don't know that we have a philosophy necessarily. We just know that there are certain things – and I don't want this to sound like that we only do things that we know the examiners are going to like – but if the banks do the things that the examiners like, that means the bank is clean. And that's why the examiners like them. You know what I mean? So it kind of all fits together. Obviously, the banks want a clean exam. But they also want to do things right. Our big thing when we go into a bank is we don't just go in and audit – that's kind of, I think, what sets us apart from some of the other firms. We actually, we kind of look at it that we're in this with the bank, and we want to do everything that we can to help them. So we go in. A few things that a bank has to have is they have to have some way of determining, this is kind of the Gordon Ramsey, there are certain things you just have to do. You have to make sure that you understand why those issues happened in your audit. You need to be able to correct them. You need to have a reporting mechanism to the board. Our reports go to the board. And really, that's pretty simple. If the bank has good policies and procedures, which we test, and so we'll let them know if

they're good or not. Any problems they fix. And then report that to the board, then that's kind of like Gordon Ramsey going in there and changing the menu. That's all they really need.

Now, the hard part is having the personnel sometimes that can do that.

What is the relationship between a regulation and a procedure?

They're connected. You have all of these regulations and some of them don't have letters, but you have all of these regulations. So let's just take a really easy one, like Reg CC – funds availability – that tells you when you make a deposit, when your funds have to be available for you to use. So the bank would have procedures on Reg CC. And it's going to start off with what their policy is. The bank can make these funds available tomorrow or in two days – that's what the reg will ask. So first they'll decide that. And then their procedures should be written in a manner than an employee or management can look at it and know how to follow the requirements of the regulation. So if the bank has good procedures, then they should be able to follow those. Some banks will have really really detailed procedures, some not so much. If you have really really detailed procedures, but you're not following them, it doesn't really do you any good to have really really good procedures.

What is a policy? What is a procedure?

Okay, well. A policy pretty much says, usually, they're kind of generic – the policy will say, tell the board, we're going to comply with this regulation, and then the procedures say how we're going to do it. So the policy will have for every regulation, will kind of have different requirements. For example, on Reg CC, there are some things the bank can decide. So that's in their policy. Our policy is going to be to do this or to do this. Some regulations, you don't have a lot of leeway. So a lot of the policies are as simple as, the bank's going to comply. And then the procedures will actually say how.

Are there policies you don't have to have procedures for?

Yeah. You're going to have ... every bank is different. The larger banks will start having sort of these enterprise wide policies and risk assessments, which are a big deal. But that's a big deal on a compliance, regulatory side. But you would, if you didn't so something, you would just kind of mitigate that out of your deal.

What's the difference between a good and bad policy?

Well, you know, there are certain things – and this is kind of funny because some examiners won't even look at policies and some of them completely focus on policies. A good policy is going to be pretty detailed as far as its going to explain everything it needs to, and it's going to be accurate. That's where we see policies mess up a lot – there's been so many regulatory changes. You may have a policy that says, here's what we're going to do, but this isn't even what the reg requires. Obviously, that's not a good policy. Your compliance program can really be as good or as bad as you want it to be. I've got one bank – they're really big on – they want their policies and procedures to be good, so they actually have a schedule and every policy gets

looked at annually. For any changes, updates in the reg, things like that. Other banks, you know, may not ever look at those policies until something changes. It kind of a hodgepodge.

Two exactly the same banks – why does one bank look at their policies and why does one not?

You know, it's really goes back to management and personnel. You've got – I will say, most banks the management and board probably don't care a ton how things get done as long as they get done. But I don't want to take anything away from the boards – the boards are active – but a board doesn't really want to know how you can hold a deposit. They just want to know that we're doing it right. So some banks will have employees that are just very black and white. Those are usually the banks that have the really good written out policies and procedures because there's some one who is just that type of person. A lot of times, banks won't look at their policies until an examiner looks at it and doesn't like it. The one thing that's a little bit different is on the BSA side. BSA is – the policies and risk assessments on BSA is a big big part of the audit, actually. That's the one act that every bank has really good BSA policies, procedures, risk assessments. Because it is really looked at as part of your program. Some of the other compliance regulations maybe not so policy and procedure driven. A lot of the examiners will take a “proof in the pudding” approach. If they go in, not a lot of problems, they really aren't finding any systemic issues – then they don't really – they're going to assume the policies and procedures are pretty good because everything's getting done. What usually will happen – they'll find a problem, then they'll go back and say, well, either you don't have a good policy on this, you don't have good procedures, and that's why this happened. That's how most of them function.

Banks have the compliance operation as they're willing to pay for.

It's not just paying, it's just all those resources. Money's obviously one of them. It's just going to cost some money to have us come in or to hire a compliance person. But other resources, like time. And things like that. Board involvement. We have some banks where the board is extremely involved, and I go to a lot of board meetings because the board – they don't want to know all the little details, but they do want to know, are we OK? I have other boards, but they don't go into it. But of the banks that we do work for are the banks that take it pretty seriously, or they wouldn't be paying for us to be in there. So most of the banks that we deal with are probably at this end of the spectrum. Except, we pick up a lot of banks because they're in trouble. A lot. And then, that's sort of what we do is help them. Most of the new banks that we pick up right now – because we've got the market pretty saturated – so a lot of the new banks will be those that have not been using us.

The small banks that don't use your type of services, are they in trouble, or will they soon be in trouble? Can they do it on their own?

It's possible. Where we're starting to see banks have trouble right now is with the new stuff. Because, if – well, you talked to Amanda at Bank of Grove? Let's just use Bank of Grove for an example. They just moved Amanda into that position that she's in. Before that, they've always done a really good job. They've been pretty clean. Before that, they kind of separated it out a

little bit. Carla did some of the operations stuff. Amanda did some stuff, but there wasn't really that one compliance person. So let's just say that it was still like that. Well, all these new changes come down because there's a lot coming. Who's responsibility is that? Well, a lot of times, that's not really defined. And so it gets missed. We'll go into banks sometimes and something will have changed six months ago, and they're not aware of it. Because there's not that person and that's their job. So now, that's Amanda's job, but it's a pretty big focus of hers. I get an email from Amanda about every other day. But she's wanting to – they want to do it right. And you want to make sure you're not missing anything. So that's where we see – had they not moved Amanda into that role, they would just – we have other banks where somebody's sort of responsible for compliance – that's where it's hard for the banks because compliance is not a full time job at a lot of these banks. I'm talking about where that's all you do is compliance. It's not. But there are times you have to spend all of your time on it. So what ends up happening is you have somebody at the bank who does a good job on their other things, so they get kind of stuck with the compliance responsibilities, too. But that's not all they do, and so it just kind of gets pushed to the side because they're busy.

In these small towns – you grew up in Laverne, and you go work at the bank as a teller, and then suddenly, you're in charge of making sure nobody's laundering money – and you may not have a college degree, and you're put in charge of a part of a regulation – and you can't read it ... how much of an issue is that in these community banks?

That's kind of where we come in. Now, I will say on the BSA side, usually, a teller – that's what the BSA side is so policy and procedure driven because you're not going to have a teller that you're paying eight dollars an hour responsible for that. But they're the ones dealing with the cash. SO you have to have procedures in place that every single teller follows that will trigger something if it's off. That's why it's so important because, I mean, a lot of the BSA stuff does fall on your tellers. And you've got a huge turnover – they're not the college graduates – you'll have a few, but most college graduates maybe start as a teller but they want to move up. So there's a constant turnover. But yes, in the smaller banks, that's one of the reasons I think we're successful is because not only is it cost-effective to hire a full time compliance officer, you're not going to find somebody in Grove, Oklahoma, that knows compliance. There's not compliance people just walking around the streets – you have to grow them. Amanda – something else – not very many people like it at all. Amanda, actually, for whatever reason, really really likes it. So she'll do really well. Most people, I guarantee you, if you went to OBA's compliance school, and you ask them, how many of you guys are doing compliance because you like it and how many of you are doing it because your boss came to you and said, you're going to do compliance. You'll see one hand over here and 28 hands over here. Nobody wants to do it. Which is one of the problems we have in hiring people. Nobody wants to do it.

How does the perfect compliance department work?

Perfect compliance department – in my mind, and they're all different – the perfect situation would be that you have a compliance person here who's sort of responsible for everything, but they're not responsible for doing everything. And then you have each business unit – your new accounts people, your loan officers – they're responsible for their compliance in their areas. And your compliance person helps them figure out what they need to do and how to do it. But she

can't go and do everything. So you've got to have some of these people. And management has got to support this compliance person. Because, let's say, you have a loan officer that just refuses to do things right. Well, this compliance officer has no control over that. And then you have an audit that comes in – and the compliance officer gathers the audit and figures out if we have problems or not, and if she does, then sometimes it's because your procedures aren't good, sometimes it's training. A lot of times, it's internal controls. Flood is a violation that is regulation that we see tons of violations in, and it's fixable, so it's a big one. You can be issued fines for flood. So, you know, if you have a situation where your loan officers are closing loans without flood insurance, that's a big violation. Somebody has to be able to say, why is this happening. If the loan officers are going to do this, then we have to make it where they can't. So, loan documents aren't going to be prepared unless we have proof of flood insurance. Somebody has to do that. If nobody's doing that, this will just keep on happening because loan officers will keep closing without flood insurance. So you have to be able to figure out those stop gaps, and if you don't have that person that management supports, then it doesn't get done.

It's not rocket science, it's just figuring out where your problem is and then reporting to the board – we have this problem, here's what we're going to do to fix it, and hey, look, it worked, then it's done. We do tracking reports, where it shows, here's the issue, here was our root cause, here's where we fixed it. And then you always test it – you can't just say, we fixed it, without validating it. Once it's validated, you show the board it's closed. And that's what we do. So your board can look and say, you know, hey, we've had these eight issues open for a year now, what's going on? That's a problem. Or a board will say, hey, look, we had eight issues, and they're all closed, good job.

Root cause. That's a big buzzword.

How many banks in OK have compliance officers?

Full time? I don't know. I would say the banks we do work for – I'd say, the ones that are probably getting close to \$500 million are starting to get full time compliance officers. Below that, maybe not so much. BOK, a bank that size, they have a whole compliance floor. They have people who are a little more specialized because it is so big, instead of having a compliance officer, you've got this one big person, but you've got people who are specialized, like in HMDA ... cause you have to.

At the smaller banks, what's the compliance solution? The guy who can't afford the compliance officer?

Us. We're a big part of it. There's other companies like us. But if they – and that's one of the things we're really trying to evolve into helping more. We've got some things that we're working on because next year's going to be bad for the banks. There's major changes happening on January 14. So, you know, we're trying really hard to – I've had banks that have called and asked if I would go out and speak to their management. So they can make an informed decision. A lot of times, the compliance people in the smaller banks, they'll sort of know what's happening, but they don't have time to – and a lot of times, you need – sometimes, you need third-party validation. Compliance officer can say something, we come in and say the same

thing, and everybody's like, oh, OK. We do that a lot, too. But the banks, you know, the banks that I've visited so far are the banks that are pretty much on the ball. They know they've got all these changes coming. They just want to be ahead of the curve and have us come out. The smaller banks, we're a big part of their compliance program. We implement the audit, but – all of our people are really really good about, OK, you're messing up on this, but we've seen other banks do it this, this and this, and it really seems to work. So we've got an advantage because we see so many banks. We know what works and what doesn't. And we'll have banks all the time email and say, we've got this problem, have you seen other banks with this problem?

A new rule comes out – and a bank has to develop a policy and procedure? How does that process work?

In a perfect world, your compliance officer or whoever's responsible for that – you know, the thing is, the qualified mortgages, is just part of Reg Z, it's already a regulation that's out there. So you've already got your Reg Z policy, so you don't have to make those changes. But normally, when there's a compliance change, it doesn't really affect the whole bank necessarily. Like, for example, in 2010, we had major changes on RESPA and Reg Z. But it was disclosure changes. So really it didn't affect everybody but those people who were preparing those disclosures. So those people went to training. You have your software that gets updated. You do all that. These changes that are coming up in January management's going to have to decide: do we want to make qualified mortgages or not? So this is a little different because this actually requires management to make some decisions and possible change everything they've been doing up to this point. They just came out in May or maybe it was June, with an exemption – they're giving us 2 years on the balloons. If that hadn't have happened, then we've got banks that were literally going to have to completely change everything they've been doing. The regs start coming out, somebody's staying on top of them, a lot of time's they're calling us and asking us about them. Once we know for sure the reg is official – that's a problem, they keep changing – we'll start sending out emails to our clients. When we're in there doing audit – we're like, remember, in January, this and this is changing – so the banks use us for that. And then, a lot of times, your final procedures don't get put into place until the reg is already changed and you actually have to start doing it. Because what looks good on paper may not actually work, which is one of the things that whoever's making all these regs are not realizing. Things sound great on paper, but you can't implement them.

Usually, like when I'm doing policies and procedures for a bank, my procedures are usually pretty – take the reg, and see what you have to do. And that looks good on paper, but that doesn't mean that everyone's going to understand it or follow it. And until you actually start doing it, you don't realize we need – there's a piece missing. It doesn't just – come January 1 next year, everyone's going to have these new procedures and everything's going to be hunky dory.

How much of procedure testing involves examinations?

At a good bank, not much. Because you should be catching that before your examiners come in. And that's actually one of the things that the examiners look at as part of a good compliance program is how well you're staying up on the new changes, and if you're ready for them and things like that. If they come in and you haven't – it shows a weakness on management's part.

I've heard folks say exams can be a learning process.

You'd hope that it's not much, though. I mean, seriously. But yes, there are things – and depending on – there are some examiners out there that are great and really want to help the bank and things like that. There are some examiners that don't feel like that's really their job – their job is to make sure the bank is doing it right.

Again, two same banks: new rule comes down. How are they different in how they develop procedures.

If they're both committed to conforming, they're both going to do OK. Where they don't – that's the ...

OK, so let me ask it this way. A CEO or bank president – how does his attitude turn into action?

He either has to spend the money to hire somebody and give them the time to do it or hire someone like us. Intentions are – it really all comes down to allocating those resources. They have to. And then they have to be willing to do it. I mean, we have gone into banks where the compliance officer would be pretty good and she's doing everything she can. Management refuses to do anything. Those are usually the ones that end up with bad compliance exams.

When a bank's policy fails – why?

Either training. Because no one knows how to follow the policy. More than often though, it's probably no one wants to.

What do you mean? The employee in the trench will just ignore the rules?

That's probably 50 percent of the time.

And it's because we're talking about a certain type of employee?

No. I mean, I can just go out here and say the loan officers are a big part of the problem, and they are. But – and we pick on them – the reason that you have people just not doing what they're supposed to. A lot of times, especially at the smaller community banks, the loan officers, the account reps, whoever, their primary job is customer service. They are there to do whatever they can – a lot of times, the regulations are counter productive to that. Even though the regulations are supposed to be out there to protect and help the consumer, a lot of times, the loan officers feel that they can't help their consumer the way they want to and still stay with it. So a lot of times – and I say loan officers because probably 80 percent of all violations are on the lending side. But a big part – it's because, not so much that the loan officers just refuse to do it but they're focusing on helping the customer and that compliance piece is very very secondary.

Is there a conflict between ...

A lot of times there's a conflict. A lot of times, it's just the last thing on their mind. The really good banks – the loan officer, if this is their job, compliance is here (higher than their job). Where either the loan officer or the loan department, it's a very big concern. For example, we have a bank – Citizen's Security in Bixby – and I go out there and do training four times a year. It's non negotiable. Every loan officer is there. Management is really making that – letting those loan officers know that this is part of your job, and it's a priority. Whereas some banks, the loan officers, maybe that's not a priority.

It's a big part of it. And it's hard to – I mean, they're all different. I can give you really good examples of what banks do bad, but I'm not going to name any names.

What's the role of automation and technology?

You know, on some of the regulations, a lot. On some, not too much at all. And you can – you know, on the BSA side, you can really automate a lot of that process. It is expensive, so a lot of the smaller banks aren't going to spend that much money to automate. You can actually buy anti-money laundering software that runs with your mainframe, and if you personally never have any cash transactions, and all of the sudden, you have a big cash transaction, it's going to kick out on the report that that's unusual for you. On the lending side, we have software that prepares the loan documents. And, you know, it's pretty useful because in theory, you go through and tell it what type of loan, and then it does all the documents that you need for that specific loan. You're not having to know everything. Problem is, nothing's black and white, so there's always something.

Where are banks getting policies and procedures from?

You'll have a few banks that will have some crazy person in the bank that actually likes writing them, and they'll come up with them on their own. Usually, you know, the Internet is full of – I don't know what banks did before the Internet – but the Internet has tons of resources and things like that. We have policies and procedures that we actually provide to banks. But usually, whoever's responsible for those will find a sample policy or they'll buy a sample policy and then tailor it to fit. There's companies out there that do policies. You know, usually, like the ABA has policies. There's all kinds of places out there. And then, you bring it in and tailor it to fit your bank. Because the reg itself is the same for everybody. So you can – so you just customize the policy or procedure based on how you're going to do things.

When new regs come out, how do banks know what they are? How do you know what's in the rule book?

What happens. Dodd-Frank is out there now. 897 pages. I do know one lady at one of our banks who has actually read it all. She's one of those I was telling you about who really gets in there – most everybody hasn't read it. Me included. Usually what you do is – there's so much stuff out there that will start coming – the FDIC sends out bulletins. The Fed's really good about sending out bulletins. The OBA has classes constantly. There's something somebody's told you about – Banker's Online – it's a huge resource. They'll start doing seminars. You just start going to these

seminars, and you start figuring out – not just with seminars but emails from us and people you talk to – you’ll start figuring out that out of these 900 pages, this part here is what we need to comply with. Sometimes they get missed. But usually, somehow it just all – bankers talk a lot – there’s a lot of – a president will get an email and take it to the compliance officer and, are we ready for this? And she’ll say, yeah, or I don’t know what that is. But almost everybody’s going to use some sort of third party. Whether it’s somebody like us or whether they’re just out there. And that’s why it gets missed a lot. Unless you have a full time compliance officer researching and stuff, things can fall through the cracks.

There were some changes in 2009 on the protection notices, and we’re still going into banks and seeing that they’re not doing that. When examiners come in, this is also a misconception, when examiners come in, they don’t look at everything. They do a very risk-focused – all three agencies do it differently – they send out questionnaires on things like that ahead of time. They’re not going to be at your bank for eight weeks, so they have to prioritize. They’ll do stuff off site. Very low risk. If they looked at something in the last exam, and it was fine, they may not look at it this time. So sometimes, the banks, because we will go into a bank and we’ll find a problem, and that’ll be the first thing they say – the examiners didn’t say anything about it. But maybe they didn’t look at it because they were focused on other areas. Sometimes, it’s hard to – the examiners can’t look at everything either. The banks can’t rely on that.

Are you hearing a lot of stuff about arbitrary enforcement?

Oh yeah. But that’s always been the case. And it’s not even – it’s just like the banks. Well, let’s just use the ... the FDIC and Fed do it different from the OCC. The OCC has examiners that go into banks every 18 months. And they look at everything, including compliance. So they have examiners that look at compliance but aren’t strictly compliance examiners. They’ll do other things as well. The FDIC and Fed have examiners that have 100 percent compliance examiners. That’s all they do. So let’s just take the Oklahoma City FDIC office – there’s 12 or 13 compliance examiners down there. Well, that office has procedures of how – just like a bank does, but each examiner is going to interpret those procedures or prioritize a little differently. It can change – your exam can change from examiner to examiner. In a perfect world, that would not be the case. Not so much vague – but very open to interpretation.

We see a lot of different interpretations between the FDIC and OCC and FDIC and Fed. A lot.

But they’ve got different missions.

They do, but that’s not a big deal for the bank. But for us, that’s very hard, because we have to know – there are certain things the FDIC looks at in a compliance exam that nobody else does. So we have to make sure in our FDIC banks are doing the things they should be.

Everybody has mentioned the “relationship.” What do you think about the role of the relationship. What are the best practices for doing an exam?

I actually really think that how you handle yourself during that compliance exam has a lot to do with the outcome of it. If the examiners come in, one of the first things they do is meet with

management. That's one of the very first things they do is have this management – but it's usually president and CEO, but the board is welcome to come. They will sit down with management, and they will ask them things – you know, like, what is your compliance program? What sort of resources do you apply to compliance? They will really drill down. If that management doesn't have a clue, it sets the tone. There are – not as much now – but a lot of times, your president and CEO, they're not involved in that. And so, they don't really know. And that's not good. The whole point of the interview is to see how much management is involved.

The only way that you're going to have a successful compliance program is if you have support from management. So they'll start with that. And if management doesn't have a clue, that exam's not going to go very well. So let's say, management's like, yeah, we're really on the ball. Well, then, the examiners are going to go into that bank assuming that this bank is trying. They're making an effort. So if we find something, you know, people are human. At least we know they're trying. If they get the impression that management doesn't care, then it's a whole different exam. It's like anything else, if you go to the store and the little girl at Wal Mart ringing you out is super friendly and super nice, if she makes a mistake, you're going to be like, hey, you made a mistake, she fixes it no problem. But if that person is rude and lazy, you're going to be all over her.

While the examiners are there, they want to get out of there, too. They don't want to be there for four weeks. They want to get in and get out in a week. So you want everything to be available for them. You want good communication. You want to be able to ask them questions – and then ask you questions. Then outside the exam, you know, there's nothing wrong with calling an examiner and going, hey, we're thinking about starting this new product. Can you tell me things we need to be aware of if we do that? Examiners love it. They would much rather the bank be proactive, than start this new product and have these problems and the examiners didn't know. The examiners want to know that you're committed and that you're trying.

There are banks out there, though, that you never call an examiner. Because that just throws up a red flag. I don't care – examiners are people, too. Just like the Wal Mart thing – if you go into a bank that keeps you standing in the rain for two hours, you're going to go in there with a preconceived attitude. But you know, we do, too. But if you go into a bank, and I really try to – I do a lot of training at banks – and this is one thing that I try to get across to them. If we go into a bank, and everything is just a mess. Their documentation is sloppy. You ask someone, they don't really seem to know what you're talking about. Then you're not going to give them the benefit of the doubt anyway. And if you go into a bank, and everything is pretty well documented, it's pretty easy to follow – people may not know everything, but at least they seem to know what you're talking about. And then you find a problem, you're going to give them the benefit of the doubt.

All these regulations are written for little round pegs and round holes. That's how they're written. None of the community banks fit into that. The regulations are not written for the types of loans that we do in community banks. For example, the good faith estimate that came out in 2010. Construction loans are not – you don't have to do a good faith estimate on a construction loan. The good faith estimates, you cannot actually properly disclose a construction loan on a good faith estimate. Can't do it. Because it doesn't allow you to have anything other than P&I

payments. Good faith is not set up for that. So that's where a lot of the problem comes in. We have to do these things, but the regulations are not set up for us to do them. So you see banks start to – they don't have a choice. Whoever comes up with the regulations never worked in a bank.

Interview No. 14

What's your background?

Been with the bank for 17 years. It's a small community bank. A family bank. A lot of the bank employees are also shareholders. Kind of a dying breed to watch the numbers and figures. When I came back with the bank – was originally with the lending – but just so happens with the fewer numbers, you also have to wear one or two other hats. So through attrition and just really continuing to gain knowledge and understanding of the compliance, I've found myself being in that compliance position and handling that for about the last eight to ten years. So I've seen both sides of it. When there wasn't a whole lot of changes to the compliance side, to now, with the recent piling on, we'll call it.

Do you have a law degree?

Nope.

Compliance certifications?

You know, for a lot of – of course, there's the industry seminars, classes. Oklahoma State hosts the compliance school each year. I have not – whenever each year or each cycle, when you have a compliance examination with your primary regulator, they want to see a resume and the qualifications of the person sitting in that position. You don't need a law degree to understand and enforce – the regulators do the enforcement. But you do have to be able to implement and have your own system, to not only comprehend them. A lot of times, they'll give these recaps in annual seminars going back. The OBA really hosts probably – you want to say, 100 percent of them – but they sponsor a lot of those seminars that will do a compliance recap of what came into play in the prior year, as far as what's coming up. So they try to give you the English version – or the Clif notes version. And those are helpful. There's just some things that you do need to be aware of that they don't necessarily impact your bank or operations.

Your experience just here in Carney?

Yes. Just banking here at Carney.

FDIC and state commission? Are you a Fed member?

We're a non member. State chartered bank.

How would you describe your regulatory environment? Friendly, supportive? More as road blocks?

You're probably working with two different segments with the FDIC right now. You have the old guard, and then there's a new face, which is a lot of the newer examiners that are being commissioned. And probably – there's two different philosophies. Some view themselves as probably the – they do have some pretty strange tactics. Whether it's burnout. A lot of the newer examiners have a different perspective on what their role should be. They are a lot more helpful. They want to see banks achieve compliance, especially in the areas of consumer, mortgage lending. That's getting a lot of attention. And that's their job, and their role, and their function in the banking environment.

Do you see a difference between the state and FDIC? In terms of tone? How they see their jobs?

Probably what happens, whether they'll admit it or not, is kind of your compliance history. If they're coming into a bank that has issues with compliance, they're going to be a little more alert, on their toes. It's going to take a while to get their comfort level up. You're dealing with two different sides. What I've seen over – not only being in compliance, but I do handle a lot of (probably 90 percent) of examiner contact when they're in the bank to help facilitate the exam and being the tip of the spear for management and field their questions and concerns – safety and soundness really doesn't care, from an examination standpoint, for compliance. Compliance really doesn't have a whole lot of concern for safety and soundness.

The best way to illustrate that is probably through overdraft programs. A lot of banks are probably acknowledging that a good source of revenue – if properly managed – they receive a lot of scrutiny from the compliance side. You won't get the same viewpoint of an overdraft program. There's not a whole lot of uniformity, or consistency, there.

So the safety and soundness exam can say one thing, but the compliance guys come in and say you're scamming people.

That's a very good way of – safety and soundness wants it because it's a good source of income. Compliance highly scrutinizes it. There are right ways to do it – but I'd say a lot of banks are probably misleading about it. We can speak freely about it because we don't operate with any overdraft protection programs. So it simplifies it for us. If people are overdrawn, we don't put them through the ringer for it. So hey, the compliance guys like it. Safety and soundness guys will say you're missing out on lost revenue and you need to find a way to get it. And they've said – without mentioning names of specific examiners – but there's a lot of them who've sat there and said, I'd charge them as much as I could everytime they went over. That was their interpretation of it. The compliance guys want to see you do it – once again, that's their role – so there are different tones.

How do you know what's in the rulebook?

You really have to subscribe to some professional services that go through and will refine – the mortgage lending laws – and you’ll get all of their overviews. You have to tackle it in small bites.

So the OBA? Others?

ABA’s a really good source. There’s other more specialized groups, I guess, that kind of – bankers networks ... Jack Holzknicht. He was an examiner for a long time. He’s got a pretty good ear to the ground as far as how to take these regulations, refine those, really pull the meat out of it. Other than that, when they’re being written, I guess really, they’re very difficult to read and comprehend when you get a 25 or 26 page sentence. It really is tough.

Do you rely on consultants? Audit?

For years, our practice didn’t change and really the interpretation and expectation on the examiner’s side has. They view it more and more as you’re grading your own work if you’re doing your own audits. And you know, that’s not necessarily completely true. As the compliance officer, you not only develop – you interpret, you develop, and you implement your own policies and procedures. Why on earth you need, then, somebody else outside of that – of their own examination – to do an interim audit, it’s just another way of, I guess, increasing that transparency of the compliance department.

Yeah, I am supposed to grade our own work. So that statement is true. Their job, then, is to grade us from the examination side. Why we need to slip in another audit in between there, the size and scope and complexity of our institution, is a little bit of overkill. Nonetheless, we will probably have to kick that in sometime next year. Working in an independent audit. And it’s unfortunate, because you’re going to pay a baseline fee, so we’re probably going to have to work in some of the consumer compliance elements, but let’s say the BSA plus the OFAC. There’s a whole lot of different elements to the compliance program, but these audit firms may say, you know what, for \$15K, we’re going to need to do two or three so you get your money’s worth. So you want us to look at your money laundering compliance procedures as well as your mortgage lending procedures. And on top of that, your account opening, your denials, your fair credit, your unfair practices. Well sure, you know, it’s like a buffet. If I can pick six or seven things I want you to look at, and it’s going to cost the same as if you were going to do one, let’s do six of them and make somebody happy.

You’re not using those folks now?

Right.

Would it be fair to say that you probably rarely sit down with the actual code and read the law?

Right. Because – your FDIC will send you – they used to send out these paper manuals. Six or seven forms. These guys, back in the day, used to haul these things around. Some of them still do – the difference of young examiners, who are savvy on their laptops – but we have some

examiners who flip through the onion skin pages and say, here's what I'm talking about. You have to read it three or four times to get his interpretation of it. You can discuss – a lot of times during the examination, you have an opportunity to explain to the examiner, this is how I interpret it, and this is why our bank has this practice. Sometimes, you can see where, OK, if they remove themselves out of the examiners chair and put themselves in the bankers chair and see how that law would be applied. I think to say that your best option of learning those rules and regulations is to go to these seminars. And really, it's because they're going to cut right to the meat of it and cut right to the chase.

Do you do seminars? Or someone else?

It's myself. A lot of the smaller banks – they'll have the one or two individuals that are responsible for compliance, and those are the ones who attend the seminars. We'll bring those manuals and binders back and touch base with the other employees and the board of directors on the relevant issues and relevant topics. Because you really – to grab that manual, or let's say that huge binder – you're not even going to get through it without wasting a lot of time. I've often wondered why they're so lengthy, the laws, but I think it comes back to how they're – I think really the burden of reading those are the ones that are voting on it. The lawmakers should read them. I think that should be a requirement. A lot of them say they don't.

There's no oversight. The CFPB has no one watching.

That's another problem. Their branching off and they're forming this new enforcement. Technically, there's supposed to be direct enforcement over the mega banks. They do have writing authority on some regulations strictly – and there's a reason why they took them over. There has been failure on the side of the Federal Reserve board on writing Reg Z. They took that away from them and handed it to the CFPB. And it does need to be rewritten. It needs to be clearer. It's way too long. They butchered it. They never line through items. It's just grown and piled on. So that's another thing that makes these lengthy regulations -- there's just still old garbage in there that hasn't kept up with the practices, but also the products that are available.

When you get a compliance exam, what makes you successful? What are they looking for to give you good marks?

Really, your procedures. Your oversight. They're not so much interested in setting down and standing in the corner while you open an account. They just want to see what your controls are.

It's taken me 14 interviews to figure out: policies and procedures. It's all about the procedures, isn't it?

Yeah. You can get the policies. We can go back in the vault and look at our policy files. Stand up files. And show you 52, for instance, I think we have from 52 to 56 written policies, just for operations. Ethics policy all the way up to consumer lending policy. You can have those. They may be covered with an inch of dust. And if they just go by that – they need to see not only do you have those and your board approves these policies to operate under. Examiners want to see that you're enforcing those to an effective level. In other words, we operate much differently

than a Wells Fargo, even a branch. Just based on the products. We can have – not really vague or watered down policies – we just don't want to have super restrictive policies that get violated every day you open.

What makes a good procedure?

Probably the knowledge – probably more than one way to answer that – your employees, that are in that compliance role of implementing your program or your procedures, they have to have a pretty good understanding of what the overall rule is but how your bank is enforcing that. If you don't have that, you really don't have anything other than just a habit. A lot of times, your habit – yeah, you want to have a little bit of that – it needs to be second hand in knowing which disclosures to offer. What makes a good procedure? Probably you've got to have a well trained staff – they have to have a working knowledge of it. And they have to understand your bank, too. Because, you know, you can understand the regulation and know that a lot of that is to provide the customer. Now, whether or not you're required to verbalize it to the customer, no. You can hand them a stack of disclosures and be complaint. You've given them all the information. But it does help, I guess you can clear up a lot of potential issues by going over some of the high points with the customer with that particular product. But your employees can do that unless they really understand what it is and what their role is.

Why might a difference occur between what you do and what the procedure says?

From somebody – human nature, I guess. You really don't ever get the shortcutting – I can't really say that. But there could be a misunderstanding in the communication of the application process. And a lot of times, it can be documented. I can give you an example. Let's say you're in here to buy a mobile home. Sounds pretty cut and dry. Yeah, your intent – or the reason of your application is – but either, if through timing – let's say you're late for work and you just wanted to get an application and go – maybe you failed to provide or I didn't ask: is that mobile home going to be attached permanently on land, and let's say, for instance, you said, well, yeah it is. Well, I failed to ask you, are you going to own that land, or are you just going to own the home. So throughout the course of that little interview right there, I may have not given you every disclosure that you would need because once the point of that – when dirt becomes part of the collateral, not just the structure, especially with motor homes, there's different laws and regulations that apply. Now, if you tell me, on a follow up call, that actually, I own it – really I've been paying on it, and I have a loan on it somewhere else – OK, are you just refinancing what you owe, or are you going to borrow some money to pay off some student loan debt? Then we just stepped in it right there on the student loan side – but if we're using your home to secure that student loan debt, then we don't have to provide you with the student loan right to rescission and disclosures, but we do have to give you other disclosures. Now, since that was your primary home, I'm really making you a refinance loan – and if the purchase of that loan is not to finance or refinance that purchase, then I'm not allowed to obtain government monitoring information on you as far as what your race, ethnicity, sex – I can't get those. I'm prohibited from obtaining them. Whereas, if it's for a home purchase, I'm required to get those. So you can see where an examiner can go, OK, all he sees is the purpose of the loan was to buy a mobile home. And it technically could have been to refinance, not only the purchase price, but a majority of those funds, and that's how they determine what the purpose is.

Then you can look back: OK, I can see where the summaries of these regulations can come in handy, because that particular scenario that I just discussed, probably seven or eight piles that you could have stepped in along the way, unless you have a true understanding of it. So you have to be able to pretty much know the requirements and the regulations all the way through. You can have a compliance concern, a violation, unintentionally, through just misunderstanding the application process.

How much of that is automated?

It's usually between the ears. Some software programs, there's more of a static – more of a dynamic documentation program. It builds the program based on the elements that you plug in. So it's kind of the garbage in, garbage out situation, that if you don't give it the true purpose, and if it's – there's some general parameters that you answer, and then it will steer you on that. But Compliance One is a WaltersSkewer product, a very big company, not only handling lending compliance solutions and document platforms – they do offer a lot of forms and probably compliance resources for a lot of industries – medical, for example. That particular product, it's evolved over the years. The program that we used to be on really did the thinking for you. You would tell it it's a 1 to 4 purchase, you've got a compliant loan, as long as you go with the checklist it gave you. It's become more – a little bit easier to make a mistake in the documentation through these newer programs. I think it's just because they're trying to take on too much. Too many states. Especially this particular service vendor, because it's nationwide, so there's a lot of different forms there that you may need to pull in for Oklahoma.

Turnover?

It depends. It really depends if you're on the providing side. Let's say you're a – and you're speaking of turnover in terms of losing a highly trained employee. That's what's going to make, in banking, really a very employable individual – someone with some compliance knowledge. I don't need to be highly trained on what's coming out in three years. I'll get that. These timelines – a lot of these things have already been passed. These laws – they're going to come into play on a timeline. They're introducing them and phasing them in. If you have an ability to digest the requirements and implement them, you're going to be a very employable person in the banking industry – or in any kind of industry, hospitals for instance.

Yeah, you do have a concern. You don't want to invest a whole lot of time and training and education without some contracts on those employees. The compliance schools are not cheap. And compliance implementation and those positions within a bank, particularly, are not for everyone. It's an acquired taste. There's been some duties I've dolled out, and I get them right back. Because it's easier to just do them. I've been there – I've seen the shortcuts. It's easier to do that, but it's so much easier to just do it. You don't have to agree with it. That's where you get into trouble. If you get employees that don't really agree with, let's say, on the bank secrecy side – the requirement is that if you have an account today, and let's say you zero it out, you're no longer a customer as of when that midnight comes over. Your customer relationship with us terminated. And you come back in and say, you've known me for ever, and I'm going to go on a vacation, and I need a thousand bucks. I'm going on a roadtrip. OK, I knew you yesterday, but

now you're a new customer. So we have to go through that. So if you have employees who see that as a ridiculous requirement, they're like, well, I won't go through all of the procedures to document that person. That's been around for 10 years – the Patriot Act. But those requirements – initially, some people have some issues with. Come on. You're the same person you've been for 15 years. Why do we have to go through this now?

To illustrate that point, I guess if you have employees that don't – it goes beyond understanding – if they don't believe in or think it's a requirement. If they use their own discretion. So you have to be very careful to put your procedures in place so that your employees aren't allowed to do the thinking on what applies and what doesn't. You tell them that it applies, you do it, or you'll probably be better suited in a different profession.

Sometimes compliance means that you can't give customer service.

Bankers probably tend to try to use that as a last-ditched effort – would someone please throw us a lifeline. The truth of it is, you can do it. Everybody knows you can do it. You can really do everything, you can implement everything. I can tell you some really bad information and smile throughout it, to where you feel like this guy really does care. So I can tell you that yes, we can close your loan, and we're going to go through a long process to get there. And you're going to have to provide more information that you can ever possibly dream of. And we're going to put that information in the file folder. And a lot of that is going to be for examiners. The more paper the better, that's the way they look at it. In other words, we may have had the approval 20 documents ago. We're good there. We have to take it to a different level to demonstrate to another set of eyes that are totally objective to look at it and say, OK, I can see why they said yes. And the documentation is the same way. The only problem is that these regulations is that they cannot make the consumer read them. They try. Otherwise, they'd put the signature line at the very front on the very top, and that's as far as the customer will go.

They look at them, but they're not reading them. They do a study and they try to find out what percentage, you know – and depending on what study – in these controlled environments, when they're observing customers, sure they're reading them, because they want their 10 dollars at the end of the day. But the consumer consumers, who try to help these regulations, as far as what information to put in the disclosure, where the signature lines could be. They're over thinking it. If they would just put a simplified version of what needs to be in there, a signature line for the acknowledgement, regardless of where it is – but evidently, these are confusing topics to borrowers, outside what the interest rate is, what's the payment amount, and when it's due. All the rest of those terms and conditions are not going to apply to nine out of ten borrowers.

When a new rule comes down – how do you write a policy and procedure for it?

We'll go directly to the escrow. That's the most recent one that we've had to employ bank wide. On paper, it sounds very simple. That's a good idea. You should have the bank collect that each month and then pay it in full when it comes due. What you run into is that maybe somebody starts paying on the halves or partial payments. That escrow is where you take the requirement, the law, regulation, you figure out, OK, this is what we need to do, how do we introduce it here, and implement it? It takes procedures. It takes training. Not only with your lending staff, but

your tellers and those that are receiving payments. And then also, you've got to have – not really an audit going on, but some accounting going on. At this point, we probably run about 45 escrow accounts, and over a 3 year period, that's a lot to have taken on and to implement, so you're handling those monies. So you get up to the tens of thousands of dollars. You have taxes that come due at the same time of the year. Your property taxes are paid out in September. But you have the other 365 days of the year where insurance comes due and premiums need to be paid. And you need to implement that part of the process. Not only the disclosure to the customer. You have to collect the money – initially, to start out with – and also on a monthly basis. And then, you've got to, sometime throughout a year's period, get that information to the customer in the form of a statement. So here's a copy that I'm going to send you. This is where it gets really confusing to the consumer. They receive a copy of their initial escrow account. They receive a copy – which the initial escrow account statement is a projection – then you have the actual, and then the forecasted. So they're getting three different statements. If you receive that in the mail, unless, they're just – you know – huge crayon or something's highlighted at the top – it tells you which statement is which, but there's some confusion there, and I think a lot of people just throw their hands up and say they're at the lender's mercy, I hope they're good guys and ladies. I hope they're honest. I hope they're handling my escrow account the way they should be.

But how did you develop the procedure?

Just manually. Really. Through a discussion.

You'll sit down and right your own?

Oh yeah. We just – usually a little brain trust meeting of those that are going to be handling it. What's the simplest way to put the requirements into place. Let's get to point A to point B the shortest route. Not make it very difficult. We talk about it, and we write out those procedures. Present them to the board. And then it becomes the plan, policy, and procedure.

Pull them offline?

It depends on the personality, probably, of that compliance officer or department or their board. Or the scope or size of their bank. It may be more difficult to just take a legal pad and pencil and get it done in an afternoon. It may take more doing on their end. They probably feel compelled to copy a larger institution's procedures. A lot of smaller banks will take the bigger institutions templates that have been posted on line and water them down. But the worst thing you can do in those situations is to have one that's too encompassing. That's not relevant to your size of bank. Examiners will spot that in a second.

Escrowing was kind of one where there's clear cut rules on that. But let's say, your requirement on the qualified mortgage side. That one's going to be pretty much cut and dry. It's going to be based on percentage, whether it's a qualified mortgage. So most banks ought to be able to draw out their own procedures and make sure they're compliant with that. Now, if they have branch lending, if they only have mortgages that can be originated in certain offices, then that's going to be a little bit easier and more refined. I guess, really, the ones that banks feel compelled to short cut and either buy or borrow off of these networks and chat rooms are probably the ones that

they're really running behind on or they have an exam coming up in a week or two, and they need to get something on the books, or in the cabinet, or in the policy file. They'll short cut it.

You've got a six or seven page liquidity policy, which is not really on the compliance side, but that's a policy that most banks have to tailor way down because that's a reflection of your balance sheet and your accounts. Your liquidity is really unique to your institution, so you really can't use someone else's. We had a situation to where we did borrow some crisis scenarios from some other banks and really were having a difficult time coming up with these crisis scenarios for certain elements – like a contingency funding plan. And the reason why it was difficult is because we operate on about a 60 percent liquidity, which means that we're not very loaned up. We have a lot of investments, and just because the loan demand is historically low here. And then those in smaller communities that borrow from you, usually, they don't want to pay you a lot of interest, so they try to pay their loans back quickly. So we didn't really have any liquidity crisis scenarios that we could think of. So we had to reach out and say, OK, we're not going to run out of money overnight, unless there's a bigger picture issue, like a run on banks. That's not an isolated occurrence, that's a national wide ordeal. No plan would even help you then. That's where we had to get out on these sites and say, for a small bank, can we see your contingency funding plan crisis scenarios.

Relationships.

Well, it goes more on not so much a relationship but a reputation. They do keep separate little secret files on the bank, on the employees, on the staff. Is this person easy to sit down and talk to, or is he difficult? So the personality of that – you have to be able to establish a good report with the examiner just because you're going to be discussing issues that are going to be critical. They're going to be – not really accusatory, but some are, they're trying to make name for themselves – you don't ever want to really just get off the track with an examination team just because ... some banks probably view it as an adversarial relationship. You know, we've never taken that approach. There's been exams that have probably not gone as well based on our policy or our procedures. But whenever they can peel back the layers of that onion to figure out, well, this is why the bank does it – maybe they got off the interpretation – but they were consistent and they enforced that regulation incorrectly, but they went to a T all the way through. So they can see that you have good procedures, so they know it's not a difficult fix. They go back to the very beginning, tweak a few things, and then just handle it the same way, but do it this way. They have a pretty good comfort level. I don't really know when a bank can get off on a wrong foot. I think a lot of times it's more unintentional. But I can certainly see how it happens. You're dealing with a human element. You've got to have a banker that's in a good mood. But then you also have examiners that have to be as well. It's, a lot of times, personalities get in the way. And that's where that examiner in charge really has to step in and say, you know what – to an examiner – we've had those situations where they've pulled an examiner aside and said, you're really going beyond what the scope of the exam is.

Do you use examiners as a resource? As a type of consultant?

Really, the things, from our perspective, that we'll bounce off them are more on the safety and soundness issue. You guys are going to criticize something when you come in the door –

everybody knows that – you have to find something, or you’re not doing your job. We don’t want to draw attention to this area, but we want to point out that this is how we’re going to handle it. This has changed. Bankers are inclined to do that. You guys are writing the rules. We’re on an unknown playing field. We’re at your mercy. We’ll throw this out there, and say, how is this going to be handled by you guys. The FDIC – you really have to have a good relationship with your compliance examiners to get a response. They try to respond, but the examiners that are out in the field. They’re already on to the bank, and they won’t respond to an email. The golden rule is: get it in writing. Everyone will tell you – Jack Holzkecht, Mary Beth Guard – anyone who has been in that role or handles it: if you don’t have it in writing, you don’t have it. So if you get an interpretation from an examiner on a regulation, and you do something based on that response, you’re better off to put a copy of that email right in the very front of that loan file. So they can see, this is how they did it, and this is why.

You have to be creative on how you obtain those – unless it’s cut and dry. But if they have to give their interpretation – a lot of times, the people will assume the regulators have read these regulations. They haven’t. They either haven’t had a chance. Or it’s not on the hot topics list. To give an example – back in 2010 when the new HUD settlement changed – December 31 was the deadline for the requirement, however, we had an examination in the first couple of weeks in January, and the examiners in the field said, you know, point blank, have you closed any real estate loans with this new statement? They didn’t even wait for a yes or no. It was “Because we haven’t had any training in that, and we’re having to scan and email and fax over to headquarters or the field office so they can look them over.” So they had no idea. They’re out in the field to enforce it, and it is a requirement, it’s just they hadn’t received all the proper tools.

Everybody knows they do it – they usually run about 3 to 6 months behind on the implementation. Now, they’re all up to speed on it, and it’s very easy for them. So there was a couple of months there when certainty, certainly on the bankers side – there’s a massive change – and a lot of heavy handed rules coming down – but yet, it was very poorly written. The Q&A section on the HUD website on the new form – they had to remove it because it got up to 300 questions. So if you have a well written instruction, you wouldn’t get up to 300 responses to the Q&As. So they just removed it. They stopped it. Eventually, they took it off because it was just a disaster. It was tough – you go to these little seminars or webinars now on properly completing the HUD settlement statement at that time, and you were getting so many different points of view. If you went to one sponsored by a closing company, it was this and you got this feeling. Then you’d go to one the OBA puts on, and you’d go, well gosh, we’re going to quit doing real estate loans. No one can do this. Then you get back to your office; you start plugging it in; you just realize it takes a little more time. Nobody likes it because it was different.

And bankers aren’t the only ones guilty of that because they have to read everything, and they have to know it, too. They’re right there along fighting that battle.

Cost? Expense & opportunity cost. What about expenses?

It’s unfortunate, and the shareholders and the board would probably like to hear that I spend more time on the money making elements of the bank. Unfortunately, I don’t. That’s where the smaller institutions suffer. In this particular setup here, I make 90 percent of the loans, but I’m

also the compliance officer. So how do you juggle those responsibilities? Compliance comes first. I want to sit down with the share holders and safety and soundness – they want to hear that the compliance is done and everything’s good, but let’s get back to the money side.

On my percentage – I probably spend about 80 percent of my time on compliance. For someone in a bank that just has compliance responsibilities, you’d want to hear that they spend 100 percent of their time on compliance. But when you have 5 different titles, because that’s what I carry. Compliance is a daily obligation, but it doesn’t always take daily oversight.

What about the monitoring activities, like with BSA?

Yeah, those are done on daily. Your tellers have to be knowledgeable about what amounts trigger documentation.

What do you spend on compliance?

Our situation, you probably have to factor in lost opportunity or lost income – but just a dollar figure, hardline cost, on seminars, say about \$5,000 a year on training. That doesn’t include, necessarily, your software programs, that you pay maintenance fees, and your licensing. There’s another \$3,000 for renewal. If you’re going brand new with a software system, a platform that will give you those documents, you’re going to spend about \$12 to \$17 thousand dollars because it’s based on asset size. To get into the banking industry right now. Say you used to bake pies for a living and you want to get in and start a bank, you’re going to have to factor a lot of cost to get up and running. You’re going to have to assemble a staff, who get trained by somebody else, and that person’s going to know that that person is pretty highly educated in that field, and they’re going to demand a pretty good salary. And compliance is one of those things that you really do – it’s almost like security on the IT side – you can be as secure as the amount of check you want to write. You can be as compliant. You can be rated a 2 or an adequate on the compliance ratings side – that gets you by. You’re making examiners happy. You have fairly good program. You may be a little bit behind in some areas, but it’s your goal – it’s on your timeline to get it addressed. But to be strong in all three areas, you’ve got to put some effort into it. The examiners, I think, appreciate it when they can see on the bank side that they really do strive. What’s the intent of the bank? Is it to get by, or is it to be helpful and good to the customers and be compliant? You can achieve both, it just takes a little more effort.

Any opportunity costs? Products/services you’d offer that you don’t?

We’re more stubborn than that. We will continue doing it and we will take the hard road. Because, we’re not in a market or an area that we can really afford to cherry pick what we want to do. Mortgage lending is an easy one that we could have kicked aside. Banks bigger than us have done this – two or three times our size have just abandoned mortgage lending because they didn’t want to deal with the requirements. It’s still one of the best investments in the market for a lender. But you’ve got to have an idea what you’re going to replace that with – if you’re going to get rid of 50 percent of your loan portfolio and not originate those loans any more, what are you going to put in its place to make money?

What's the difference between you and the bank in the panhandle that has ditched loans? You're in the same type of community – but you decide to make a go of it and they haven't?

It's really, what are you going to replace that with? And, are you servicing your customers and your community by abandoning a certain product that's needed everywhere? They look at it from, not only, what we need to survive, but what does your community and your core base of customers need? Because if we only made Mercedes automobile loans here, we wouldn't be servicing what a majority of our customers needed. Your examiners would see that, too. And that would be more from the CRA – the community reinvestment act – is the bank really servicing the community where they're taking their deposits. So that's another issue the panhandle bank would have to answer. I'll take your deposit, and I'll loan it out at another branch location, but I'm not going to make you a home loan because we stopped doing that. And there's not really any discrimination there, but there's other issues when you abandon a product. You better have a pretty good reason and be able to illustrate that it's not profitable.

The burden's on the bank to illustrate how that's not profitable. Because you're likely to encounter some fee income. You're likely to encounter some other business products. A checking account is considered – it's mislabeled, it's not free money, because you don't pay interest – but the cost of maintaining a checking account is a cost. But you can get that money and invest it in other things. A bank would really be hard pressed to say, just because we didn't want to mess with it anymore, that's the truth. Now they could probably paint a scenario to where it didn't look profitable to do it, but they'd be hard pressed, the further you got into it, to show that it wasn't profitable. Now, if you just say, you don't have the staff or you can't devote that many resources, in most examinations, regulators aren't going to argue that much because they know it's a burdensome task. Now, if I made 50 loans in a year that were all non-compliant, that had fines attached to them, and I had a bunch of Reg Z violations, which are tied to money and compensation and reimbursement-based fines, that could really be a non-profitable situation. So I could see how the bank is going to say, we're going to stop doing it. And the regulators would be in agreement. They'll give you a cease and desist order to stop doing it until you get better training. We'll tell you when you can get back into lending.

Interview 15:

Banks switching over to state charters. Have you thought about that?

It's always been a national bank. It's been a family-owned bank since 1919. And there was a time there when he was thinking about switching over to a state bank several years ago but decided he would just stay a national bank.

Regulated by the OCC. How would you characterize that relationship?

There was a time that they put us in with Wichita, one of the banks in Alva was switched up there. When they were switching territories around. Most Oklahoma banks were still out of Oklahoma City, but they put us into Wichita with the OCC up there. And that was different. We're fixing to have an exam here in a couple of weeks. This will be our second exam with the

OCC back in Oklahoma City, and it's much better to be examined by the Oklahoma regulators – they know Oklahoma. The one that's usually the head of the group that comes here as bank examiners – Kyle's been here.

How do you know what's in the rule book?

Just by reading and by staying up on some of the legal briefs, newspapers that we get. Or OCC will send out bulletins. Of course, there's no internet banking here. There's no online. All of our posting is online. The compliance that way, we don't have any of that extra compliance. Through the BSA, we'd know all of our customers. Anybody can walk through the door, and we can call them by name.

For a small bank, it's really difficult. Of course, this is kind of a low-technology bank. Simple in nature. So there's a lot of that stuff that doesn't apply. But we know what we have to deal with and the regulations that go along with that. I get lots of emails from the OBA, ICBA, community bankers, you know. And they pretty much keep you up on what's coming. I depend a lot on examiners. I really do. There's no way that a small bank can keep up with it. The big banks have a hard time keeping up with it. A lot of times, I'll just wait for an examination and wait for them to tell me. Well, you know, yeah, I can get that done. We can do that. But boy, I sure wasn't aware of that. Which is true. That's generally the case.

I don't read through regs. If I have a legal question, OBA has legal staff. You can go there. Other banking organizations have the same thing. There's legal stuff that comes out every month, in the OBA newspapers that they send out. Legal issues – those are easy to keep up with, you know. But it's literally impossible to sit down with and go through regs. It really is. I generally, through other sources, I can get what I need. Generally speaking. Sometimes, like I said, we just have to wait for examiners to tell us.

Do you use consultants?

We have an internal auditor – she audits all the various functions of the bank. We also, about every 18 months or so, we're also on a schedule with our internal auditor. Well, they do pretty much just a director's audit. We can get by with it, and it meets OCC criteria. It's just a director's audit. And it doesn't go into – those CPAs – they don't deal with bank regs, you know. And whether or not we're complying, they just do a basic director's audit of the bank.

So the examination is your consultancy?

That could be.

Do you think examiners' attitudes have changed? Does that help them help you?

They're going to help. Where banks get crossways – we've always gotten along fine with examiners. And now, we've been back and forth – we were with Wichita for a while, and now we're back with Oklahoma City – they can be awfully difficult. Particularly with banks that have problems, you know. They'll sure – they can sure be tough and difficult. But a bank like this, and

there's a good many of them around the state and this area, and don't have a lot of classified loans and inventory on their books, repoed inventory and other real estate owned and all that kind of stuff. So those banks, it's a little different. They treat you different. We're among the safest banks in Oklahoma as far as classified loans go and general safety and soundness. What you asked a minute ago about my background – I graduated OSU in 72 with a BS in wildlife management.

You've been doing a good job.

Lisa has a business degree. She worked at a bank at Jet before she came here, and I kind of stole her. I went to Texas with the parks and wildlife and came back here.

Why not a state bank?

There was a time when we looked at changing to a state charter. In fact, I don't really want to say anything against the state banking department – but I just ran into problems with them. I terminated the process, and this bank has always been a national bank. Started as a national bank. National banks are, to my way of thinking, a cut above state banks. I think the Oklahoma Banking Department is good in what they do, but I just think it would have been a big mistake if I would have followed through with it. There are some advantages with a national bank charter. There's advantageous both ways. I've always kind of held the opinion that you get what you pay for, and I'll leave it at that.

Best practices for examinations? What do you do well?

Compliance and policies are a big deal. Compliance with the various regs that we're required to – takes annual approval of those – there's a certain list of them, of important regs. Interest on deposits. Privacy. BSA. Reg O – for officers and directors. CRA, lending limits. There's about ten or twelve regs that they usually hone in on to make sure you got your annual. BSA – anti money laundering. And then, in addition to that, it's going to be loans, documentation, inspections (livestock and equipment), cashflows on larger borrowers, tax returns, financial statements, filings, lien filings, that sort of thing. IT – our computer operation, our mainframe, is always a big one. IT would be separate from compliance issues, for the most part. They just, want to make sure that you're electronic operation, your computer operation is safe.

Procedures are important? What's a procedure?

On complying with it?

Yes.

There's a policy in place to comply with the reg. For the most part. And the examiners always want to see these policies. We want to see copies of your policies. There's a loan policy, an investment policy. Lots of other policies. Policies that cover other things besides compliance.

But the procedure?

Well, yeah, but in reality, we don't do that. In practice. A small bank has advantages over larger banks. We deal with people we've dealt with for 30 years. They walk in my office, one on one, I type it up, and out they go. You don't find that in the larger community banks, like in Enid. That's just the way it works here. We don't have to go through – now, with a new borrower, yes, we run a credit report, and go through the whole thing. Tax returns, bank statements, we have to keep that updated on everyone, for the most part. But those things like that, we've done it so long, we have a loan committee. If there's a loan that we have, for some reason, need some additional input on it. And all new borrowers go the loan committee. For the day to day lending, there's not a lot of decision making unless it's something out of the ordinary.

We don't make mortgages – now, we'll make agricultural mortgages on unimproved land. We don't make any home loans. No residential. We had to get out. We used to make them – but with the meltdown and everything, they just made it so difficult, I had to get out.

On procedures, again.

They want to see them written down. But not particularly – we've got a loan policy, a general loan policy that is our guide – the types of loans we can do. How much in general terms we'll loan on something. But it's general guidelines like that. Yeah, they want to see it in writing. But as far as checklists – we know the liens we've got to file. We know this. We know that. You just do that. In addition, it's in the policy as well.

What's the difference between a good policy and bad policy?

Well, it's got to just meet their criteria. And they'll tell you. If something's missing, trust me, they'll tell you. That's the only way I know to answer this question. If it's a bad policy, you'll hear about it. There's certain things they want to see in there, and they've got to be there.

Are there regulation changes on the horizon that you're having to develop new procedures?

No. Not really.

So when Dodd-Frank gets passed, it doesn't affect you too much?

Not too much.

What's the reason for that? You seem to be copacetic with the whole thing.

Well, for the most part. But there's some truth to that. I wonder if Washington isn't trying to put a lot of the small banks out of business. Yeah, I think that's a given. So I'm not – in that regard, well, I'm just not a big a fan of the U.S. government as I used to be.

Is it because of the products and services you're offering – that they're the same, so you don't run into a lot of constraints?

That's true. We don't have internet banking, so there's a whole range of things that we don't have to deal with. We do provide basic products, debit cards, and that sort of thing. But there's no e-banking. That gets us out of a lot of stuff. The bigger banks are just into so many different other things. They have fiduciary capabilities, trust departments, lots of other stuff. Our examiners are good. They look at everything. But the bigger banks are so much more complex. They're into so many different things. Different investments. Different product scenarios.

How much performance is related to the cost of regulation?

In a way, it's had a huge impact over the last five years. With interest rates – what we can go out there and get, like overnight fed funds are like .2. The artificial pushdown on the rates for this long a period has definitely impacted our earnings. We've continued to make money, but it's sure been nothing like what we used to do, under just a normal type of interest rate. They artificially push those rates down. They create bigger problems down the road. There's going to be a reckoning one of these days. It'll probably be pretty bloody.

Are there products you've quit offering?

Well, of course, the mortgage loans come to mind. That was a compliance issue. We had some mortgage loans pending when they came down with the regs, and I just ended it. I really can't think of anything else in particular.

Overdraft?

Oh, that was something we had to deal with, and we did. We have an overdraft protection program set up. On the consumer side, that was a big deal, and we had to comply with it. It was some effort to do that, but we got it done.

Conflict between customer service and compliance?

Yeah, you know, I'm sure there are those cases where it has some effect. But I don't know. I would say it was minimal.

Relationships?

Well, yeah. If you have a question about something, you can pick up the phone and call. They may have to go to their legal department, and they generally say, let me check on that. But they do. They will. You want a good report with them. OCC is our regulatory agency, so they're our examiners and our regulators. We don't really deal with anybody else. We don't deal with those people.

What about the relationship during the examinations?

You want to be straight forward and very truthful with them. We just try to treat them like anybody else. Like our customers who come in the door. They appreciate that. When they make

their request or tell you need to do something, you do it. You don't give them a hard time about it, you know? Certainly, you can stand up for yourself if they have a question about a loan and they don't like something, it's up to you to defend it. You don't just roll over. We just try to be nice. You're defeating yourself if you approach it any other way.

I'm sure there are bankers that give them a hard time. I would think so, that there would be. I would say probably the banks that have other troubles, there's more of that.

I heard a story once, not that long ago, it was here in Oklahoma. They went into the bank, and one of the cocky kind of loan officers just popped off. Said something like, we always charge women and minorities more. Something – he was just popping off. He was being sarcastic – oh yeah, we discriminate. And oh my gosh, he said that to one of the examiners, and they threw a fit and put that bank on all sorts of regulatory difficulties. They can kick me out of the bank. They are all powerful.

Do you see a lot of consistency between exams?

I think both. Typically, there's a lot of consistency, but examiners do what they're told. They do what Washington tells them they have to do. So they're under the same thing, basically, from Washington that we're under with them.

How receptive is the OCC to what you want?

You just do your best to defend it (a loan rating disagreement). In the end, you just accept their classification. And in most instances – and it goes back to, is this bank safe and sound or not? – it goes back to that. If they classify a loan, yeah, I can see some deficiency there. I generally – oh back, there was a time when we didn't do cashflows. And I kind of had a problem with them on that, when we were at Wichita, and it's like, oh, gosh, we've known these people for 30 years. I see it every day. But still, you've got to have livestock inspections, machinery inspections, you need to do cashflows. Well, you know, eventually you do it. But you kind of mitigate it if you can. We have a \$100,000 limit – anything larger than that, we have to do a cashflow on that. That's placated them, and they're fine with that. That's in our loan policy.

How have you gotten better at doing compliance?

You know, you just get a feel for it over time. Regulatory guidance and requirements, you have to change with those. The hot topics, there's always a hot topic. Something like the mortgage loans, and those always come along. So you just – I guess you just gain that over time from several different directions.

What's the difference between you and that small community bank that closed due to regulation?

Banking has changed. It's tougher. Everything has gotten tougher. The regulatory burden – that's probably – you finally reach a point where you go golly, this small community bank, the

regulatory burden and the costs associated with it has reached the point to where it is too difficult for us to continue and you sell out. That's the biggest issue without a doubt.

Why are you still here? Why haven't you sold out?

I've got a good compliance officer and a good vice president. In our simple banking is certainly an asset in that regard. So far, we've been able to handle it. It's tougher, yeah. A lot of things are tougher. But we're not in that group of banks that just can't do it anymore. I survive OK. Lisa and I – here we are in our little world, and we do OK. But if I went to Oklahoma City with some bank, I probably wouldn't survive.

What's your attitude toward regulation?

There's no question that banks are overregulated. There's always that knee jerk reaction out of Washington. When some big bubble comes up, they're going to fix it, and all they end up doing is screwing it up. And they end up doing the exact opposite of what their intent was. They just make it more difficult on the customer. Just like us – we used to do a lot of mortgages here in down. We didn't have any foreclosures. We've taken over maybe two houses in thirty years. One was a trailer, one was a home. But it's, yeah, the regulatory burden is huge.

Does it serve a valid function?

Certainly it does. But they always overdo it. Always. They always overdo it. They try to fix something and end up making it much more difficult or worse. That's my opinion about that.

Interview 16:

This is my first savings and loan. Are you subject to the same set of regulations that national banks are?

The same. In fact, The bank across the street has examiners right now, OCC, and they're the same set that just did us a month or so ago. They're there now.

What's your background?

I'm president of the bank. Been here 31 years. Came here right out of graduation from Oklahoma State. Double degree in accounting and ag economics.

Do you have a CPA?

No.

Have you always been at this bank?

Yes.

Is it a family business?

No. We're a little bit different form of animal that you'll find compared to other commercial banks. We're a mutual form of ownership. I don't know if you've come across that or not. It's similar to like a coop, in that we're owned by our members, or our people who do business with us. So there's no shareholders.

In terms of your regulatory environment? The OCC – is anyone else involved?

The OCC is our primary regulator. Every bank is also subject to FDIC because they provide insurance of accounts. They ultimately have the right to come in and examine us. But they'll accept whatever the OCC says.

Would you say the folks at the OCC tend to help, hurt?

I guess, kind of neutral. And not just the OCC – the regulatory environment is overwhelming, and it's getting worse by the day. There is another agency, it's relatively new, again, every bank is subject to, and that's the CFPB. They are just going wild writing regulations. And it seems like we get emails – and every little bit, your email will ding, and it's something from them that they've written a new regulation. For small banks, in particular, it's getting to be overwhelming and just hard to manage. Larger banks that have a staff that handles compliance, it's still got to be overwhelming for them, but at least that's their job everyday when they come to work. That's compliance. Whereas, a small bank, we've got to wear a lot of hats.

How does compliance work here?

I do a lot of that myself. I try to pass off some things. Try to help out. It's probably not as structured or formal as it would be in a large bank. We address things as they come down the pike.

Do you deal mostly with them?

Yes. Part of that is, we've just hired another young man here, it's his third year, in those three years, it takes a long time to get up to speed, so he's still relatively new at the process.

How do you know what the rulebook is?

We don't.

Everybody keeps saying that.

Nobody knows. The congress that accepted it didn't know what was in it. Part of it is you have education things – you go to seminars. You read periodicals and things of that nature, and they tell you the things that they've gleaned out of it that are really applicable to us. And that's what we have to rely upon.

Of your time, how much is spent reading the law?

I don't know. Five percent, maybe.

So you do do some.

Yes, I have to.

In terms of knowing what the rules are, what are some of the other things you rely on?

I get a lot of emails. We're members of various trade organizations. The OBA, the regional trade organization called Heartland Community Bankers, and we're members of the ABA. All of those duplicate the same task of sorting through things. And the things that are relatively important. So it's emails, seminars. Periodicals that come across the desk. Things like that.

The OBA does regulation workshop once a year. How much of that do you participate in?

Usually two or three a year. On different topics.

Regulators themselves put on workshops. Do you use those?

A little bit. To me, their's aren't as helpful as some of the others.

What about consultants?

Well, we don't have any outside consultants. We've just – just the trade organizations. And of course, the people they use for these seminars are consultants.

What about folks like Jack Holzkecht and Mary Beth Guard?

Well, Mary Beth Guard is a free service through the OBA. He's actually part of – I think it's the same one – if it's the same person I'm thinking of, his firm is called Pegasus, and there's at least three people who are speakers, regular speakers, that are part of that firm. I've listened to Jack, and I've been to several of his seminars, and another guy who does BSA.

New rules come out – are there other ways you know about new rules?

Like I said, these speakers and these periodicals.

In terms of your performance, what portion is influenced by regulation?

The main thing is just taking our time. Expense wise, I don't know if you can put a number to it. Being kind of informal, we just have to address it. There's things they won't let you do and real restrictive on normal business.

Are there products and services you'd be offering if it weren't for regulation?

Right now, I wouldn't say that there are. There are some that we currently offer that are jeopardized, but it looks like we're going to be OK on. Some of what they've thrown out would really be devastating to us if they go through.

Do you do home loans?

Yes.

And January, qualified mortgages hit.

Yeah.

In terms of compliance, and say the examination, how do you succeed at the compliance exam?

All these regulations that we're talking about – they come in. One of the things that has changed with OCC is they don't necessarily look at everything when they come in. They expect – well, let's go back to your previous question about expense – we are now required to have quarterly audits by an outside firm. And so we have to pay for that, and it's fairly substantial.

Compliance audits?

Yeah. We were with a prior regulator, being a savings and loan. There was an office of thrift supervision and they went away, and the OCC took their place for us. With OTS, they would look at all those regulations and things themselves. OCC comes in and says, we don't have time for that. You've got to hire these outside auditors, and so we have people who come in quarterly who look at – there's a long list of regulations, and they'll take this many this quarter, and then another group the next quarter, and so on. We have to pay for that. And then, when OCC comes in, all they basically look at is that company's reviews.

The OCC – does that enable them to focus on safety and soundness?

They say so. They contend that frees them up.

How long has this been the case? First time I've heard that OCC requires audits.

It was new to us, but they say they've always required it.

I've only recently figured out that policies and procedures play a big role.

Oh my.

Nobody brings them up. Maybe it's because they're taken for granted. Help me as a guy who's trying to figure it out. What is a policy? What is a procedure?

That's just a list of policies (pointing to computer screen). And it goes on and on. And every time they come in for an exam, they want a new policy, or they want something added to it. You know, it gets pretty ridiculous with things that you would just ordinarily do through the course of business. To me, the downfall of policies is that the only people who read those are the examiners. And that's about the only time they look at it – is at exam time. From exam time to exam time, every 18 months, they sit stale. Granted, I can see where what they're wanting you to do is to write down what you're going to do and what you're not going to do, and if you do something that's not in that policy, they're going to hang you with it.

What's the difference between a good policy and a bad policy? What makes them smile?

They're always going to find something. That's their job. They're going to find something. Of course, no bank can disclose their ratings, but we're a highly rated bank and I can say that they are always going to find something. That's just the nature of things.

But specifically – what's a good policy? What don't they like?

Like I say, if you have an investment policy, they're going to want you to have certain limits on where you will invest your money. That you're only going to invest so much in this company. In other words, you're not going to have all your eggs in one basket. You're going to have limits on your margins. Interest rate risk is a big thing that they're concerned about. So they want you to have monitoring policies and procedures in place to do that. And if you get outside those guidelines, they're going to want to know what you're going to do to fix it. Same with capital. Every bank is required to have a certain level of capital. Say you have to have a capital plan, if you started losing money and got down to low net worth, they're going to want to know what you're going to do to fix it.

When do you make a mistake? Why would you go counter to your policy?

Well, you're just human. Human error. It's like, I've heard people say, if you don't make a mistake, you're not doing anything. There's going to be mistakes made. Generally, if your examiners are good, they're not going to write you up for a mistake. They're looking for an overall program that's out of whack. One of the policies that's the most scrutinized – it's just a huge deal – is the BSA. That, again, is one if they come in and find some little deal that you haven't done right, the program itself says they're not supposed to be critical of that. If the whole process is out of whack, they're going to be highly critical, and they can even fine you.

Procedures, then, are where the rubber meets the road. What's a good procedure and a bad procedure?

I guess, just one that leads to the wrong results (would be a bad procedure). If you have decent procedures in place that's got checks and balances, it's going to work at the end of the day. Then it worked. If it doesn't work, you've got to change that procedure and figure out a way to make it work. One of the things that helps us here, I said we're a pretty high rated bank, we've had a longevity of people. Even though we're a very small bank, me and the president across the street

– even though we’re competitors, we’re friends, and we talk – and he for some reason has gone through a cycle of losing people. And it’s just frustrating, you know, because, then, if you don’t have the people who’ve had the experience and gone through this, and you’re trying to teach not just one but several people at the same time. It’s easy to not have those procedures in place.

I imagine turnover would be a big issue.

Yeah, it can be good and bad. And sometimes, the longer we’ve been here, the longer we get ingrained. You don’t want to change with what the regulator’s telling you to do.

Do you ever ignore policy in favor for customer service?

Not a lot. To me, I think a lot of times, like you say, it helps being in a small community where you do help people. That way, like making loans, you have a pretty good handle on who you can trust and who you can’t. Of course, that’s what the regulators want is good procedures for approving people and part of that is knowing them.

When a new rule comes down – how do you develop policies/procedures?

A lot of it is just – language, what you find out – you learn what examiners are looking for. And they’re wanting to see the same terms that were in that regulation. So a lot of it is just going through there and picking up what they’re saying, and you know you’re going to be OK if you use their language, it’s going to work.

So you write them yourself?

Yep.

Have you ever thought about pulling them offline?

I don’t know. I think it could be, but you know, I guess, to me, examiners – if I was an examiner, I’d frown on that, because, you know, if you’re just using a cookie-cutter type deal, it’s not going to be appropriate for every bank. Our policy should be different from those across the street, to an extent.

In the time you’ve been here, have you gotten better at policies and procedures?

I hope so. Over time. I don’t know if – just to get – it has got to be so many more. The president who was here before me, we just talk about how much it’s grown and they never take away anything. It’s just everything has expanded.

Any tangible ways in which you’ve gotten better?

I think just experience, you know. And learning what the examiner’s looking for. Of course, every examiner comes in – is a little different. And they come in looking for something different.

We've learned that with – like I mentioned, we had OTS, and OCC is different. They look at things differently. You have to look at things in the way they're going to be looking at it.

Consistency between examination teams?

Again, going back to OTS – because we've only had OCC exams so far ...

How long did OTS go away?

Just about three years ago. Like I said, we've only had two OCC exams. Just finished one a couple of months ago. The one before that was 18 months prior. Prior to that was OTS. To answer your question, OTS was awful about being consistent because those teams came from all over the United States. The last OTS exam we had was a team from California – they knew nothing about farming or agriculture or anything like that. It was a fiasco trying to explain why we did what we did. I'll say this for OCC – the two exams we've had so far, they have been more consistent. They come out of Oklahoma City, for the most part, and even the people have been consistent.

Do you think your OTS experienced prepared you for compliance?

No. It just made us bitter. Bitter instead of better. Because they'd just – they didn't understand. And trying to put a square peg in a round hole.

Ever think about turning to the state bank commission?

In fact, we were a state chartered institution, and we were having to pay, at that time, OTS, we were having to pay OTS for examinations and we were having to pay a state fee as well. So we got to thinking, why are we doing this? So we dropped the state and we're just now a federal association. So I'm not really familiar with doing it the other way because I think those people – if they're state chartered banks, they're still having to pay OCC, I think. You know, they may not have to pay – it may be different when we were with the OTC instead of the OCC, because of the OCC and being state chartered are kind of being the same thing. But we actually were a state charter institution and switched the other direction and saved money doing it.

Who do you go to when you have disagreements with the OCC?

It hasn't been a problem for us because we don't really have any problem loans, to speak of. If we had bad loans, like in the 80s – the 80s were a whole different ball game.

Relationships? Your past good compliance?

I think it surely helps, but I still think they come in. Part of what seems to be the deal, because there are no big issues, they start nit picking. They feel like they've got to find something. If they just walk out of here and say, great, they've got people to answer to, too. And it'll look like they didn't do their job. So they start nitpicking little things that shouldn't amount to anything.

How do you handle that?

It's kind of frustrating. Not kind of. It is frustrating. Those things – they don't come easy. It takes a lot of work to make sure everything's run well. When they start nitpicking, you think, we work pretty hard at this. It's frustrating.

Are you proactive in communicating with regulators?

Yeah. We check with them on things that may be questionable. We'll call before we do something. We don't want to come in at exam time and have them say, oh, you shouldn't have done this. We want to know ahead of time.

You don't ever want to surprise the regulators. Have you gotten better at it?

Yeah. I think just – that's the way I was brought up with the prior president. It's just kind of a – we've always, oh, I use this as an example from way back. There was a guy's name – he was – Jack, another Jack – he was an OTS examiner, and he was known to be real hard nosed. But his sister lived up here in Aline, and she did business with us, as a matter of fact, and through his recommendation. He came in and just knew that we operated clean and when he came in here, it wasn't a big deal. But a lot of other people thought he was just a bear. Was real hard to deal with. So we have always tried to do the right thing. That doesn't mean examiners don't find something that they can pick at or complain about.

What are some of the best practices of exam time?

Just having – they've always got a laundry list of what they want to see. Have those available for them. Easily readable and accessible. Things of that nature.

Who handles the interaction? Other employees?

Really not. This last exam, there was six of them and if one wasn't in the door, there was one waiting at the door.

Are there other folks – do you do training with staff?

There is some. With all the regulatory change, that's something we're going to have to enhance and formalize. There are programs, and banks already do it. You can go on now and take a little test and watch a little video and take a little test. We're going to have to implement that, get it going. Our training's been less formal, and that's something they want to see.

Write a procedure or policy? How do you do it? Especially with the ambiguity?

Oh just dig a little deeper and go to a seminar or something. Not all of that is applicable to us.

Would you use the examiners as consultant?

That's not really good. You're looking for problems if you do that. If they go in there and you've done a lot of things wrong – some of them can be devastating because there are monetary fines.

Are there products and services that you offered and don't offer now?

No. I don't believe so. Of course, we've always been pretty basic. We emphasize home loans. A lot of the smaller banks in this area will recommend their customers to us. It's been part of our expertise. We have to do it (it's a large part of what we do).

Is the CRA a big part of that?

It's not a huge thing to us, again, because we have so many loans, it's such a big part of our business. It's already there. For other banks, it might be more of an issue than it is for us – because it's a big part of what we do.

How active are you? Do you lobby?

That's not my cup of tea. I don't even like local things like that. I'd rather stay here in office.

Do you participate in comment periods?

I've never written a comment. Sometimes, there will be drives and encouragements from OBA – they'll send us out a form letter to send to our congressmen. I've done that before. I got to thinking, maybe those can't be very useful because they're getting the same letter from everyone.

What is your attitude toward the role of regulation?

I know why – or I feel like I know why these things happen – is because there's a few that go crazy doing things they shouldn't have done in the first place. Somebody's pushed the limit, so out comes a law. That's the way it is with banking and everything else. Someone's pushed the limit, so we have to be subject to it then.

Do you feel like regulation is punishing/consolidate banking?

I do, I guess. It's not something I lose a lot of sleep about. But I think that – and it's probably true in every – again in every facet of business. The fewer they have to look at, I think the government would like to slim it down, get more control of things. But that's going to eliminate jobs in the long run.

And kill local communities.

I was at a meeting just a few years ago, not too awful long, it was in Oklahoma City at the offices of MidFirst bank – they're a savings and loan as well – they're the largest in the state, one of the largest banks in the state. And the meeting was at their office, and it was with congressman Lucas. And there was just four or five bankers there. The president of MidFirst – I appreciated what he said – because that's part of the thrust was it looked like they were trying to

eliminate all the community banks. And he said, I'm not going out to Fairview and putting in a branch or going to these other small towns. There's a need for those small banks. Like I said, I appreciated what he had to say. He wasn't going to be out here to help those people, so better do what you can to keep us here.

He would have to – or someone would have to come out here.

I don't guess they'd have to.

The biggest thing about credit unions to me is, something banks have been lobbying for ever since I've been in the business, is their tax free status. To me, there's no legitimate reason, when we're needing tax money, that they get a free ride. Because they're legitimate competitors of banks in every way.

How about farm credit?

They're also a competitor. You don't hear so much about them and their tax status and things – of course, they're a direct governmental entity, whereas credit unions, you know, are doing their own thing.

Do you think your S&L experience in the 80s made you better?

Well, yeah. It's surely helped. We were like a lot of other banks – we were just one notch from survival at that point. There was – the president then – if you were me, would you be looking for something else, and he said, you gotta stick it out. And I guess I'm glad I did. Things have turned around. I think it would have turned around for a lot of failed banks, banks that they took under. If they had given them a little more time – if they were good operators, they surely could have determined the good operator from the bad. If they were a good operator, their bank would have turned around because real estate turned around. But there were some that were just loose cannons and had to be taken out.

In those days, regulators had a beef – thought bankers were crooks. That's different now.

I think so. Yep. It surely has. There's always bad apples in every bunch.

Interview 17

What's your background

I went to NEO here in Miami for two years, and I was doing business management. And I started working as a teller and just backup to the cashier, doing whatever was needed. I went to Missouri Southern, finished up my degree in business management, and right after that, I started auditing when I was already working here. So our president moved me into an auditing position, so I audited this bank and the bank in Wyandotte, which the president owns. And the cashier – the COO – retired, I took over as operations officer. Back in 2010.

Compliance part of your duties?

We all play a role in the compliance. However, our president is the actual compliance officer. And then – like I said – we have committees that are assisting the president in making sure that all the compliance options are met.

State bank – so state and FDIC?

Yes. We actually governed and audited by the Federal Reserve bank as well, and we are a state bank, so we get reviewed the Oklahoma State Banking Department as well as the Fed.

So you're a Fed member. No FDIC?

Yes. We do not get – we are a state bank that's chartered, so we have FDIC coverage, and we have opted in to participated in FDIC coverage, but we are not regulated by the FDIC. We're regulated by the Federal Reserve. So that is a little confusing. If you tell people you're not FDIC, then they think coverage because that's all the FDIC is known for is their insurance. The regulators are the state and the Fed.

Is it true the state commission doesn't care about compliance? Just safety and soundness?

The Oklahoma commission is going to do more safety and soundness exam, but in saying that, everything that goes into safety and soundness is compliance based, so you cannot get away from the compliance issues. Compliance is a big role, and we get criticized on compliance areas even on the state exam. But the Fed – they will nail you on compliance issues. In a harder, more direct fashion than what the state banking does. They will – I mean, they will – they're the ones that you have to worry about. The state is more there to make sure that you're operating at a level that is satisfactory, that they don't foresee any problems. The Fed is the one that can pack a punch and can either fine you, can give you a cease to exist order – they're the ones that you really have to worry about what you're doing in compliance.

Have you always been a state bank?

Yes.

Always a Fed member?

Yes. Since I've been here – since like the end of 2007. I don't know before that. I'm pretty sure that we were always the same. We appreciate the knowledge and the almost the help that we can get from the state institution. Before you get to that federal level, they'll come in. They'll make sure everything is good to go. Give us a little prep, and tell us what we need to do. If there are any recommendations, then we get audited by the Federal Reserve. A lot of times, they'll hold together. The state will come in and say, this is what we recommend. And it falls in line a lot with what the Federal Reserve is going to say anyway. It is nice to have that.

Part of the state's mission is to help?

Nope. They come in and do an exam. During that exam, they will give you recommendations. They know what the Fed is looking for, even more than what we could ever know, because they're in that area. That's their expertise is auditing and examination.

I've heard that the state commission can be used as a consultant.

Yes. That is true. Because they're kind of the supreme authority on what's going on. And whatever they say, you pretty much have to comply with. Especially in the compliance side. We have to comply with what the Fed says. And one of the things as a small institution that we're able to do – like I said – H.C. (the president) can be the head of the committee, but then compliance as it affects operations, that is my department. Compliance as it affects lending, that's our loan officer's department. Compliance as it affects IT, that's our IT department. And so all of us, if you take all five of the different areas that we're looking at in an exam, then we will all use our knowledge about what's going on in our specific area, report back to H.C. as the compliance head, and then he will have a greater understanding of how the bank is meeting all of these specific areas. That has been a lot more beneficial when it comes down to exam, because they break it apart. When they come in and they want to know how we're meeting all these areas, they want to know how operations is day to day, how loans are meeting with compliance, how IT, how security. And so, when we do it that way, he has more direct information from each department coming in. H.C. can make a better determination of what our bank overall – that's his realm as president. He wants to know 10 years from now, what we're looking at. He is a broad spectrum, whereas I am a day to day person. I'm looking at this is what I've got to do each day to make the bank balance. So he gets a little piece from each member of that committee, takes it back, and makes a broad decision about First State Bank compliance overall.

We feel that these committees, that the members and how we're breaking it apart, is the most effective way for a small bank to manage any compliance issue. Because compliance is so broad. But so important. It's a really broad topic, and you have to break it apart, in my opinion.

You can be as good at compliance as you want to be – just depends on what you're willing to pay.

What they're saying is – what my president tells me – he tells me from the beginning – is you cannot hardly get a 1. They are going to give you 2s. The only thing that you can get a 1 in is something that is mathematical. Say, liquidity. Ratios. Also ratios, liquidity ratios. Things where it's a mathematical formula and you either have it or you don't. It's pretty hard for them to give you a 2 if you meet the criteria. Everything else, they're going to give you a 2 more than likely. That's not, you know, necessarily how it happens. But that's what he's always told me. So he says we strive – we still though, at our bank – strive to get a 1, but we are not disappointed when it comes back at a 2, and we've been working as hard as we can. Because it is very difficult to get a 1 in all of those areas. And so, what we decide is that we will work as hard as we can to achieve the 1, but we're not going to be, you know, put down, we're not going to feel like we've been defeated if we get a 2. I know what they're saying – the paying for it thing is real. Because we are small, we have a dedicated number of funds that we can use. Those funds have to be

allocated among, you know, to get resources for the entire bank. If we spent the money, like they said, for a compliance department, we would have to hire three additional people, and we would have to have auditors in here, internal controls, and different people. Our loan officer acts as our internal control officer. That's not only because he wants to – that's not because he wants to but because that's all we can do. We have to have internal people who are going to perform these roles because we're going to function without that cost break. I understand what they're saying – if we wanted to try to get a 1, which we might not ever get anyway, we would have to hire additional people. And they're already telling us at the Fed level that we're spending so much on employees. We want to tell them that's because you guys are making us to comply with all these regulations that are impossible. So it's impossible for a small bank to allocate the funds needed in all these different departments. So we've decided that we will do the best we can. We will strive for the 1, but if we get the 2, we almost expect it. Because we just don't have the funds. We don't do home loans – this is something you might want – we don't do those because the compliance section of it is too tough. We can't make any money. So we just have to cut our losses some way.

It's funny you say that the Fed says you have too much labor expense.

They want you to increase profitability. But they want you to decrease – but it's a lawsuit waiting to happen. And we're not going to fight those battles. We have a \$20 overdraft, and we've been told time and time again – everyone else is going to \$27, why don't you go to \$27. And we say, well, we're not going to do it. Because you'll get criticized, one side or the other. What you can take – you have to balance it. It's honestly like a skill: how much criticism can we take in this area and how much can we take in this area? You can't go to a three. If you're really high in one area, and you've got 1s, keep those ones there – don't get criticism in that area because you don't want your other area to fall to a 3. And that is how you have to work as a small bank. It's not what you want to do. But you definitely don't want to take extra criticism just to make a dollar. That's not worth it.

How do you do compliance – and tie your answer to a specific regulation.

Well, generally speaking, what we do – we take a look at all the regs upfront, and that's something that H.C. and myself look at together, and we have a lot of training, and we get packets and briefings on any changes that have been made. You know that up front. We get yearly updates – sometimes biannually, as needed. But we take those regulations, and we put in place a policy. Everything in our bank is done by policies. So we have a policy to meet Reg C, to meet Reg Z. We have policies – all types of policies. If it's not in our policy book, then we have a policy that – it doesn't even make the book – but it's still a policy. We still write it up, how we're going to meet with this. We have checklists. We use tables.

What do you mean tables?

Like – what is required for a loan to meet this regulation, say on the loan side – you have five items this way, and you make sure that you check off on a table that you gave them the notice, that you gave them the disclosure, that you mailed it out, that the customer sent it back, that you gave them this ample opportunity. All of the items that are required to meet a regulation are put

into that table, and all you have to do is check it off. You get either a checklist or a table for each specific regulation. Each department does their own. Loans have to meet reg A,B, and C. We have to do D, E, F. You divide them up. Then we make sure that the person who's over that department is making sure that each one is met. Every loan gets a loan checklist now. Everything has to be checked off there. Every new account that's opened has a checklist of the items, now, that we have to meet. The new accounts secretary has to check those off before it comes to me. Same thing with all of our, stop pays get under some of those regulations, all the daily operations stuff, and we just put together a system that works in each department. Pretty much, now, it has to be a check list. It has to be a table. Something visual. Because you will miss it. If you try to read and interpret that regulation, you will not do it. You will not ever meet what you're wanting. They want to see each section of the regulation broke apart in a table.

And it's where regular people can read?

Exactly. We put it in those terms. There's a lot of resources you can get Online that you can print samples off of and make it custom to your institution. BankersOnline. Places like that – you can get all of the resources that you want. It is there. The banks that are struggling are the ones that are just not doing it. If you are trying, and you are doing something, when they come in to examine you, they are going to give you some prop for just, hey, you got the table, you're trying to use it. Maybe you didn't interpret it the same way we did at the Fed, but at least you're trying to meet everything that you can. The ones that are in trouble just don't do it.

The tables / figures. Those aren't procedures are they? Just tools to follow?

Tools to meet the procedures. The procedures are outlined in the written policy. And we go a step farther and identify those procedures as step-by-step tables, items, checklists, things like that. Just to make it – like you said – if I have a 18 year old teller, I want to make sure that 18 year old teller, who doesn't know the regulation, so I have to give them something, you tell the customer A, B, and C. Only A, B, and C. And you have to write down that you told them these things. You don't tell them that if they structure a transaction in a certain way that they're going to tell. You only tell them what I tell you to tell them. Things like that. Because – not everyone here has the banking background. That's something else that you have to – I'm having to take compliance here at this level and all the knowledge that I know and break it apart so that anyone off the street that gets hired as a frontline teller, seriously, can meet the compliance requirements. Because they are not exempt. It is not Nikki has to have compliance for her bank – it's everyone in First State Bank has to operate at this compliance level. That's really important. That's what a lot of examiners do not understand – they'll say, well, do you know what section 8 is.

They'll go ask a teller that?

No. They'll be talking to me. And I'll say, yes, I understand that. And they'll say, why do you do it this way? And I'll say, that's what I told them – because how am I going to – they don't know what that reg is. They're not required to know what that reg is. They're only required to meet the procedures that I put in place to meet a compliance rule.

Has there been a change that you could walk me through – how you develop a policy/procedure and then make the tools?

Let's use funds availability. Funds availability always said that we are going to give someone available \$100 when they have a hold on a check, we're going to give them \$200 now. Now we have to give every person \$200. All we do – and most of the changes are this easy – when they change something. They rewrite an entire reg just to say \$100 to \$200. That's all you get out of it. Once you break it down and figure out what they actually did – that's a good one. On that policy, Reg C – we're going to say, now it's \$200. So H.C., as president, he is in charge of rewriting the policies. He goes to our policies and procedures and how we're going to deal with this. And he will say, OK, from now on, we have to change all notices, we have to change everything to \$200. He changes the policy, procedures, brings it to me, and says, Nikki, this is a change that's going in effect. We notify customers. This is the new change as of, you know, this date, our bank is going to be under this new regulation. We change all of our print outs, all of our hold forms. Everything like that. And then, we do a training, in house, of all the tellers, telling them, you know, now you have to give them \$200. So that's a basic one, but honestly, that is an actual one that changed. Most of them that are changing are not actually changing an amount like that. That was a huge change. We actually have to give the customer \$100 extra. That affects everyone in our bank – all the tellers, all the accounts people, myself included, that affects everyone in the bank. Most of the reg changes are going to be things that do not affect the tellers and the customers directly. Most of them are going to be like a change that says your ATM now has to be handicap accessible. You have to – that's a new thing that's going on, you have to be able to plug in headphones so they can use their headphones if they want. It has to talk to them. Our ATM wasn't talking to people. You have to make it talk to people. If they can't see, they can hear all of the prompts. Things like that. Those are just things you just have to upgrade your software. Upgrade your hardware. But when you get one that actually says, hey, from now on, you're going to give them \$200, you have to go from senior level down, and do that. And so that's what we do. He rewrites a policy, gives a copy to me, we talk about the changes that have to be made. I make all the operational changes. And then we train. Then we require that our tellers attend just an in-house briefing on every regulation change that affects their job.

The loan people, they go to outside training. They go to outside meetings, from the OBA. Because their's are so in-depth with the loans. They're too indepth for HC and I to just tweak a policy. They go to the training. They bring back packets of information of how. They pretty much give you a procedure at the meeting. Say, this is what we – they give them a breakdown, like, in your bank, this is what you're going to have to change. These are the steps you're going to have to get in place. They don't tell you exactly, make a checklist. But they tell you, this is basically what the reg is saying. They break it down for our loan officers and president can understand it. And then, they do the same thing when they come back. The training is just different. Instead of starting with HC and moving down, we actually start with an authority on the subject.

All of us, in our different committee, go to these annual or semi-annual meetings and get all the knowledge we can on compliance issues. It's called Compliance Roundup is what the OBA does.

There's a lot of grey areas in lending. On operations, if it says \$200, it's \$200. Lending is a lot more challenging. I was in lending before I did compliance.

How does the committee structure fit in to say, how, on the day-to-day of compliance?

We use online technology a lot. We email back and forth. When there are – we sign up for a lot of email alerts. From OBA, from Bankers Online, places like that. Anytime something is going to affect us, HC and I and Danny all get an email that says, hey, this is happening today. Then HC emails me or Dannie, whether operations or lending, and says this is what is coming. We need to read this. We need to be aware of it and note down the date of when it's due. When we're going to have to be in compliance with the new change to the reg. From there, we can set up a meeting of that committee to get everything in place. It does happen – it happens instantaneously now because we all get alerts. One of us will be contacted from HC. He has to be the head of compliance, so he will send the alert to me, saying this is happening today, did you get the email? If not, he forwards it to me, and says read this. Then we do a plan of action. Technology has made it where no we're alerted right away.

Do you rely on all these other consultants?

Yes. Mary Beth Guard. Holzknicht. Pegasus. There's also Pegasus. He's a training guy, too. We do have an audit team that is outside, and it's Folker Data, and they do a BSA audit and an IT audit. And when they do those audits, they do hit the compliance issues with BSA. My operations side more. They are outside. We hire them to come in and check everything. They check new accounts. They check pretty much everything I do operational. On the lending side, we have an auditor that we've hired an auditor – she does not work at the bank, but she comes in once a month and checks the loans. We still do business loans – if they're commercial, you have to have insurance, they have to have RESPA. Mortgage in the jacket. All of those kinds of things. And it's checklists – she goes through and checks everything. So we do have a few people hired to assist us in finding any problems with our actual procedures and making sure procedurally we're hitting it. But when you're just talking knowledge about what's going on, we don't really hire a lot of people for that. We rely more on HC getting information. There are so many sites out there that are free. So many update classes. They're going to tell me ahead of time in the next six months, be looking for this to happen, this to happen, and this to happen.

On the compliance audits? Are those required?

Yes. The Fed doesn't tell you exactly what you have to have in that regard, but they do say you need someone looking at it. Someone has to look at it. They don't say we have to hire a specific person. But you have to have an internal control. That is straight from – Oklahoma state and the Fed will tell you – you have to have an internal control program. You have to have an internal control officer. Then you have to have someone auditing the loans. Outside of the department. Someone has to be looking at those. They'll flat out tell you that, so we hired a lady. Then they'll also tell you that you have to have an audit, and they want to know the last date of your audit for these certain areas. BSA. For IT. For all these things. So they don't tell you specifically how you have to meet these requirements, but they are all required.

When you have a reg come down – that’s ambiguous?

We actually like to call. We’ll call and get some of the knowledge and the insight from someone. And what they usually do is they give you a contact – she’s an examiner, she’s going to be in charge of my bank. If I have any questions, I’m supposed to call her. They’re going to be coming in, and the best person to get your information one is going to be the one who’s critiquing you.

So she’ll also be your examiner?

Yes. She’s an examiner, but she might not be on the next exam. They just appoint you a regional person that works for the state banking department. They’re all examiners. They appoint our bank a specific contact, and we can use that contact as much or as little as we want. But the more you use that contact, the better understanding you have of what they’re looking for. With Brooke, I can call her and say, this is what I read, so how do you want me to implement it. And she’ll say, this is what we’re thinking for our exam. How we want to see it happen in the bank. She’ll also tell me, but I bet you need to go one step further for the Fed and include this, this and this. Because she’s already talked to the Fed. When she gets an email saying this reg is changing, she calls the Fed. She has a contact at the Fed. The Fed says, OK, in Oklahoma for a bank this size, we’re going to require this, this, and this. So she knows. It’s a chain – everyone gets the same update on the reg changing. It’s just that you follow the chain of commands – if you need to go through the state then the Fed. Then get all the information from that person that you can. It’s all free! Contact them – it’s free. Do not make up your own policies and procedures. That’s what banks do that kills them. They make up a plan. They try to interpret the regulation like they want to. They interpret it terribly. Because the Fed does not say everything clear, so folks will say, Oh, I think they want us to do this. Just call them. Call them and say, how would I do this?

Would you ever call the Fed?

Yes. I have a good contact relationship with the state, so they’d usually be my first. But I call the Fed help line. We call whoever we need. If it is something that Oklahoma state says – that we are not there yet, we don’t even know what they want, it’s too far out – we also get emails about, before they’re even put into place, we can make suggestions. We can put in comments – you can make comments on the exam, on what you think. You can make comments on the regulation. Things like that. We’ll get a lot of emails, comment on this and tell us what you’re thinking and tell us how it’s going to affect your bank. We do talk with the Fed, but the state breaks it to a point where I can understand it better.

What about the bank that doesn’t have it written down (Nash)?

They will be criticized. A bank cannot operate out of – I’ve been told this several times – you cannot operate unless it’s in black and white. They don’t care if you do it every single day – and they’ve told me that in the past – you do a lot of stuff that you don’t document what you do, and you don’t get credit for that. And we do above and beyond what is required – we might check accounts every day where some banks check every month. And she says, give yourself the credit. They will be criticized for not having a black and white checklist or something where they can go back and say, this is what they did. They don’t care if you do it 10 times a day, if you don’t

write it down, they don't care. They will be criticized for that. The only reason that they have not been shut down is because they probably talk their way out of it. They probably talk their way out of it – they probably convinced them that they're doing it somehow. And I guarantee they have more procedures than what they think they do. A typed up paper on my computer telling someone how to do my job = procedures. A typed up checklist on the tellers station that says to check the ID, check this and that = they will accept that. You don't necessarily have to write at the top of the page: this is the procedure for Reg Such and Such. If you can prove and put together a case in everything in your bank, they'll accept it. They're not here to shut banks down. They want banks to grow. But they will be criticized for not compiling.

Do you feel like there is some benefit for experience? Does the examiner give the experienced person slack?

Because I've been in the bank for about six years, I have learned as I go what to do and what to say and what not to say. And so in the beginning – I don't think that they think that you know less, and I don't think that they intentionally change their exam procedures based on experience. But, because of experience, you do know what to tell them. I know more this year what to tell and what not to tell than last year. Not that we keep anything from them, but you don't want to get yourself in trouble over something that's not an issue. And that's what you'll do in the beginning because you'll say, I don't really know. You *don't* say, I don't really know. In the beginning, you might say, I'm not sure what you're talking about. No! That is not an answer. They have always told me that I run this bank in a tighter, in a more black and white, like I was telling you, and more of a procedural fashion, that they like than a lot of people that have been there a long time. Because I have to – I don't have that experience, so I have to make sure that everything is done A,B, and C. So they actually like to examine me a little bit better than they like to go to HC. HC just tells them, I know what I'm doing. It's worked so far. And you don't have anything to criticize because we've been doing this. And I look at him, and I'm just like, you've got to be kidding me. How does he get by with that? And I'm like, no, let me find the documentation that he's talking about so I can get it to you so that they don't explode. But he can get by with that. Like you said – some people can get by with that because he has a history of, you know, doing X, Y, and Z. I have to *prove* that I'm doing X, Y, and Z. You know what I'm saying. You do learn a lot. You learn more and more. But the only way that I can do my job effectively is if I know what is required. And you know, so somewhere you have to get the information. You have to be pulling that information. You have to be using it. Because it is – it is all about the rules. It's all about following the rules. So yes, in a way, they might try to be harder on you if you're new. I don't think they try – but it might seem like it's a little harder – but it's only because you do not know how to handle their questions. And it's nerve wracking. Especially in the beginning. Because it's your first time and you think they're out to get you. But after my fourth year, I'm like, OK, whatever. I own this exam. You guys work for me. And you guys work for me. They're trying to help me. But in the beginning, you're scared and like, they're going to shut us down. Now, I'm like, here's what I do and you tell me what else you want me to do to be better. I prove to them now that we're better than what they're giving us credit for. That's what my job is now. At some point, you get comfortable that you know as much as they do. I do this every day. I know more about my bank than they do. I know my customers. I know what I'm doing. I don't know how many years it takes everyone else, but after being here for a few years, I thought, no. I know what I'm doing, and I'm not going to let them

intimidate me. I'm going to prove to them that I'm doing more than what they ask. And that's how I approach it.

Eventually, you'll know more than they do – because they rotate out.

Definitely. That's how I felt last year. We do come across people who are new. They're new, too. They have new people too. I mean, I just shred them. I just shred them. She comes in and says, well you have to ... and I'm like, where did you get that. That's not required! You just tear them apart. I had one girl almost crying. They just don't – because you cannot bring attitude without knowledge to back it. You cannot have that attitude without the knowledge to back it. And she learned pretty fast that she better know exactly what she's talking about because HC and I will not go for anything besides what's written. That's important.

How do you know what's in the rule book? But maybe that's not a good question because it isn't an issue?

All you have to worry about is the changes. Our bank is founded on a platform of regulations that make the whole bank work. The only thing that we are concerned about – that's why it's called a "Roundup" not "Compliance A to Z." It's just rounding up the last year and anything that's changed and how do you build on the regulations. I cannot tell you every regulation. But I can tell you that it's wrong for me to go out there and do certain activity. I can't quote you every regulation in the book, but I can make this bank run just by what I have been trained from people that, you know, that have got some regulation background. And that's what important. You don't have to know what they all are, but you have to know that you're operating in a way that is conducive to those regulations, and all you have to worry about are those changes. That's it. Just the updates. You aren't required to know it all. You can't know them all.

Has something changed? Did Dodd-Frank, CFPB, and all that affected what you do?

No. Not too much. Like I said, a lot of the regulations, the changes do not affect us directly. A lot of the regulations are because large banks have so much trouble. And if you fall – if you are under \$50 million in assets, and you're in a small bank category, a lot of times, those regulations are not going to affect us. Another thing, like I told you, we're not doing the home loan side for purchase. That takes out a lot of the regulations that we have to meet for that. So we have to follow all regulations, but a lot of them are just not going to apply. They aren't going to affect our day to day operations. Because of our size for one. But because of the services we provide, too.

You all seem pretty relaxed about the situation. Small banks. Middle sized banks seem to be freaking out. What's the difference?

Because once you get over that threshold, everything applies. Pretty much.

Asset threshold?

Yes, but not just that. There's a lot of different thresholds that change you from a small bank to a medium sized bank, and every agency is going to give you a different number. We use \$50 million as a general guideline, and we are a very small bank, and we're a community bank, which is a little bit different. We're not a state bank, which is a little bit different. We aren't commercialized. We're not Chase. But once you get in that realm where everything applies to you, you do have more responsibility. You have more to uphold. The other thing is: they don't understand – if they're worried about stuff, it's because they have a lack of understanding about what they need to do. They're not writing new procedures and policies correctly. They're department is lacking. They'll have a compliance department, if they're that big. They'll have people who, all day long, that's what they do. And I think, sometimes, all they're seeing is the reg. If you separate it out and I have one team that all they do is the regulations, they would go crazy. Because all I do is I take the pieces that I know I have to have and I just stick them into play and say, ok, we're fine, we're doing it. And I think they're concentrating so much on getting them to the letter, and they're trying to do all of them at one time, and they're trying to do it at such a high level, like I told you, that senior level, that compliance level, that they're not looking at all you have to do is make a checklist, give it to the teller, and have them do it. They're trying to make it into something it's not, and it's because they have a lack of understanding of how it actually works in the bank. And that's why you do not want to separate compliance from your operations. You don't want to separate it from your employees. You don't want to separate it out. And that's why we love the committee. If they had a committee that actually worked in their bank that actually saw this stuff every day, they could put it into play. Instead of looking at it in a broad spectrum on paper, they would actually know how it enacted inside their institution. And that's what's missing – there's a link missing. I worked for IBC here – they were so disconnected. Disconnected, disjointed, is the only way to describe that bank. The whole thing. No one was on the same page. No one knew what was going on. And we never heard the word compliance. We never heard the word operations. We never heard anything. We ran a deposit through a deal and gave a customer a receipt. We were no more a part of their planning, of their procedures, of their policies, than one of my cashiers. We were a cashier. And they never once told you about regulations. You never heard anything. How do they expect those people to understand what they're supposed to be doing, what they're supposed to be complying with if it's never even spoken. And I worked there like seven months, and I wanted to pull my hair out. Exactly like what you're saying with those middle banks. It's a disjointed feeling. I worked here, and I understand banking. There, I knew how to give a customer a receipt for a deposit. Here, you understand banking. You work it every day. Compliance is your life. Operations is your life. Lending is your life. You are so in tune with what's going on. Every person that you ask of my tellers, when you tell them, what's a change that's been done here lately, they may not tell you the reg, but they'll tell you every change I've made in the last year because that's what they have to do. We were told nothing. A computer screen would pop up and say, you have to give the customer \$200 and put a hold on the rest.

They try to automate everything.

They *tried* to?

But the teller doesn't always have to do it. Okay, X, escape, enter. They don't know what they're doing. They don't know what that means. They don't know, oh, you know – I know this, I was

18 years old – and you're typing in, like, oh, it says something about, we probably ought to get a secondary ID because this person's over \$10,000. You have no idea about a CTR. All you know is a screen pops up and you have to ask them for their driver's license. If someone asked me what it was for, I wouldn't know. All I'd know is that I have to put in their driver's license number. That is wrong. And that's, like you said, why they worry about compliance because they are trying to take that – they're trying to automate it into a system that is going to not let their tellers make a mistake. You know, they print out reports and forms every night. They don't have to do any of this. We look at it by hand. We look at our BSA stuff by hand. Our currency transactions. I look at it by hand every night. My tellers – if you say CTR to them – they know what they're filing. They actually file the report themselves. They know what the requirements are. They know what the law is. I had none of that at IBC. It was the most disjointed place you could work. They separate it and raise it to such a level – and senior management – you never even hear the word compliance. I mean, that is a problem. It might work for them because it's the only way they can automate their system. To hire that many employees and have that many people working and to do the number of transactions they have to do in a day. But I guarantee you, if they would train them even a little bit on the actual principle of banking, that they'd be a lot better off. Because when I went there, I learned how to use a scanner. That was our training. You learned – you know – how to count money. That is not banking. And that's a problem. That's why we are so – that's why they get in so many lawsuits. Why they lose so much money. They make money, too, that's why they're always under criticism. Chase, BoA, IBC – money laundering problems with them. But that's why they have so much trouble, because they're not training people banking. They're just not doing it. And I would never go back.

So a large – the volume – it'd be nice to automate it.

I guarantee you, one push of the wrong button, you get half of the forms they need. And you do not know – I worked there – because they do not know. It'll give you five forms instead of ten because they hit the button. And they never know. My lady that opens a new account, she gets so much training that she should be able to open it by hand. She should know what forms she has to give them by hand. Compliance One is great – it's going to print out the forms for her, but if it's wrong, my people know. Their people don't. That's the difference. We have the same capabilities that they have, but our people are knowledgeable. I'm not saying we're the best ever – I'm just saying at small banks, that knowledge is common. We don't have that kind of system that's going to do everything for us. We do it by hand, and you learn so much more. When the examiners come in, you don't say, our software does that. We say, I look at them every night, this person and this person and this person – I check them all. That's where you get a difference. And they're rated a four – a three or a four – and we're going to get ones and twos.

What portion of performance is influenced by regulation?

You are talking about regulation – our expense for compliance is going to be right here (legal and professional expense) – we have legal and professional, and then we also have our director's fees, which they tie into compliance. Our board of directors, they have a meeting tonight – every month they have a meeting, our memberships and subscriptions, our legal and professional, and our director's fees, and our public reports expenses. Those are where you're going to find

compliance items. The legal and professional is all of our auditors. Then your public reports assessments, that's your FDIC, things like that. Then you've got a little bit up here.

What about top line? Opportunity costs? What aren't you doing that you'd like to be doing?

We would like to do purchase loans. We would like to do house loans for purchase. And we are unable to do it. One of the other major things is we have to service charge our customers for checking accounts, and we have monthly service charge that goes from \$6 to nothing, depending on their balance. We do have an over-40 free checking, but for the vast majority, we're having to service charge. And that is because it costs us so much for those programs to run. We have to have the Compliance One program, and we have to surcharge our customers. We have not increased overdrafts, but I would like – a lot of banks give free checking. We're unable to do that at this point with all accounts because we have such a cost invested in the software. And it takes us so much time and energy to maintain an account. So those two things are a big thing.

Did you used to do homeloans and drop out?

Yes. We did.

When did you quit?

I think it was about 2011. The escrow – we started doing that. We set up savings accounts instead, and we just made deposits with their monthly payment in their savings. The deal was just too many regulations – too much compliance. It was mainly when they started changing RSPA – the truth in lending. When they started changing the right of rescission, reg Z – instead of changing all of that where you had to do so much, it just got to where we couldn't comply. We didn't have – we have a president, and he was making our house loans. Well, the president of your bank is so busy that he can't do this. So all he does now is business purpose, rental houses, properties, because they don't require you to do as much of the checks. And because you actually just showing that they've got the income they need to cover it, they relax it. But just in the last few years, right when I first started, we did home loans all the time. We couldn't make the money, though. They gave you a limit on how much fees you can charge. Origination has to be this much of a percent of the loan. And they want you to do that in two hours where it was taking us two days to put together a loan. All the ratios they wanted. They just couldn't make the money.

Was it a big chunk of your business?

We lost interest income, of course. Because you're talking 20-year, 30-year notes instead of five or six year auto. We lost a lot of interest income. It was not a huge portion of our business, but I would venture to say 20 percent of interest. That's a big deal. But we have recovered a lot of that because we've had to learn how to make up for that, and so one of the things that we've done is we've offered a new car loan rate that was lower than what we had before – to try to entice people to borrow more. We also started a big commercial line. We started trying to get people to

borrow for their businesses, and so we supplemented not having the house loans with having the big commercial side, which still gets you the 20-year interest, a little bit of higher rates.

We lose a little, but we've replaced it because you have to. You can't lose money.

APPENDIX 4

IRB APPROVAL DOCUMENTATION

ADULT CONSENT FORM

OKLAHOMA STATE UNIVERSITY

PROJECT TITLE: Institutional capabilities and entrepreneurial advantage: Bridging the gap between regulatory management and opportunity

INVESTIGATOR:
Christopher Pryor
Doctoral Candidate
Oklahoma State University

PURPOSE:
The regulatory environments in which organizations are embedded are becoming increasingly complex and dynamic. Moreover, in some industries, the regulatory environment sets boundaries that limit the markets firms may pursue and the types of products or services they may develop. These boundaries may also constrain the internal processes of the firm.

However, some firms may develop routines, or capabilities, which better enable them to 1) perceive regulatory change, 2) interact with regulatory agencies and agents, and 3) even manipulate regulatory boundaries. These capabilities are referred to as institutional capabilities, and firms with these capabilities may be better equipped to pursue new markets and develop new products and services. The purposes of this research is to understand the nature of these capabilities, through conducting interviews with individuals involved with regulatory issues in the banking industry, as well as understand how firms may differ in their development and possession of these capabilities and link these capabilities to entrepreneurial outcomes.

PROCEDURES
The purpose of this interview is to more fully understand the specific activities that banks use to perceive, interact with, and manipulate their regulatory environments. The interview will last approximately one hour, and the principle investigator will ask a series of questions related to the bank's regulatory environment, the bank's regulatory activities, the bank's culture regarding the importance of regulatory compliance.

RISKS OF PARTICIPATION:
There are no known risks associated with this project which are greater than those ordinarily encountered in daily life.

BENEFITS OF PARTICIPATION:
As described above, this research seeks to understand how banks perceive, interact, and manipulate their regulatory environment as well as to link these activities to entrepreneurial outcomes, such as new product and service development and improved performance. The results of this study may, therefore, be of use to banks and other firms operating in highly

regulated environments. At the conclusion of this research, the results will be made available to participants and banking trade associations.

CONFIDENTIALITY:

Interviews will be recorded and transcribed within a week of the interview. Once transcribed, the audio recordings will be deleted. The transcribed interviews will not include any information that would identify you or your bank's participation in this study.

The transcripts of this study will be kept private. Any written results will discuss group findings and will not include information that will identify you. Research records will be stored on a password protected computer in a locked office and only the principle investigator will have access to the records.

CONTACTS :

You may contact any of the researchers at the following addresses and phone numbers, should you desire to discuss your participation in the study and/or request information about the results of the study: Christopher Pryor, 223 Hanner Hall, School of Entrepreneurship, Oklahoma State University, Stillwater, OK 74078, (405) 762-0347 or Justin Webb, Ph.D., 104 Business Building, School of Entrepreneurship, Oklahoma State University, Stillwater, OK 74078, (405) 744-3325. If you have questions about your rights as a research volunteer, you may contact Dr. Shelia Kernison, IRB Chair, 219 Cordell North, Stillwater, OK 74078, 405-744-3377 or irb@okstate.edu

PARTICIPANT RIGHTS:

I understand that my participation is voluntary, that there is no penalty for refusal to participate, and that I am free to withdraw my consent and participation in this project at any time, without penalty.



Oklahoma State University Institutional Review Board

Date: Monday, October 28, 2013
IRB Application No: BU1359
Proposal Title: Institutional capabilities and entrepreneurial advantage: Bridging the gap between regulatory management and opportunity
Reviewed and Processed as: Exempt

Status Recommended by Reviewer(s): Approved Protocol Expires: 10/27/2016

Principal Investigator(s):
Christopher G. Pryor Justin W. Webb
104C Business Bldg 104C Business
Stillwater, OK 74078 Stillwater, OK 74078

The IRB application referenced above has been approved. It is the judgment of the reviewers that the rights and welfare of individuals who may be asked to participate in this study will be respected, and that the research will be conducted in a manner consistent with the IRB requirements as outlined in section 45 CFR 46.

The final versions of any printed recruitment, consent and assent documents bearing the IRB approval stamp are attached to this letter. These are the versions that must be used during the study.

As Principal Investigator, it is your responsibility to do the following:

- 1. Conduct this study exactly as it has been approved. Any modifications to the research protocol must be submitted with the appropriate signatures for IRB approval. Protocol modifications requiring approval may include changes to the title, PI, advisor, funding status or sponsor, subject population composition or size, recruitment, inclusion/exclusion criteria, research site, research procedures and consent/assent process or forms.
2. Submit a request for continuation if the study extends beyond the approval period of one calendar year. This continuation must receive IRB review and approval before the research can continue.
3. Report any adverse events to the IRB Chair promptly. Adverse events are those which are unanticipated and impact the subjects during the course of this research; and
4. Notify the IRB office in writing when your research project is complete.

Please note that approved protocols are subject to monitoring by the IRB and that the IRB office has the authority to inspect research records associated with this protocol at any time. If you have questions about the IRB procedures or need any assistance from the Board, please contact Dawnett Watkins 219 Cordell North (phone: 405-744-5700, dawnett.watkins@okstate.edu).

Sincerely,

Handwritten signature of Shelia Kennison

Shelia Kennison, Chair
Institutional Review Board

VITA

Christopher Garrett Pryor

Candidate for the Degree of

Doctor of Philosophy

Thesis: INSTITUTIONAL CAPABILITIES AND ENTREPRENEURIAL ADVANTAGE:
BRIDGING THE GAP BETWEEN REGULATORY MANAGEMENT AND
OPPORTUNITY

Major Field: Entrepreneurship

Biographical:

Education:

Completed the requirements for the Doctor of Philosophy in Entrepreneurship at Oklahoma State University, Stillwater, Oklahoma in July 2014.

Completed the requirements for the Master of Business Administration at Oklahoma State University, Stillwater, Oklahoma in 2009.

Completed the requirements for the Bachelor of Arts in Journalism at the University of Oklahoma, Norman, Oklahoma in 2004.