Minutes

of

The Meeting of the Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

October 15, 2009 - 8:36 A.M.

The meeting of the FDIC Advisory Committee on Community Banking ("Committee") was called to order by FDIC Chairman, Sheila C. Bair.

The members of the Committee present at the meeting were: R. Daniel Blanton, President and CEO, Southeastern Bank Financial Corporation and Georgia Bank & Trust Company of Augusta, Augusta, Georgia; Charles G. Brown, III, Chairman and CEO, Insignia Bank, Sarasota, Florida; Deborah A. Cole, President and CEO, Citizens Savings Bank and Trust Company, Nashville, Tennessee; Craig M. Goodlock, Chairman and CEO, Farmers State Bank of Munith, Munith, Michigan; James H. Gray, Chairman, Beach Business Bank, Manhattan Beach, California; Jack E. Hopkins, President and CEO, CorTrust Bank, National Association, Mitchell, South Dakota; Timothy W. Koch, Professor of Finance, Moore School of Business, University of South Carolina, Columbia, South Carolina; John P. Lewis, President and CEO, Southern Arizona Community Bank, Tucson, Arizona; Jan A. Miller, President and CEO, Wainwright Bank & Trust Company, Boston, Massachusetts; Rebecca Romero Rainey, Chair and CEO, Centinel Bank of Taos, Taos, New Mexico; Bruce A. Schriefer, President, Bankers' Bank of Kansas, National Association, Wichita, Kansas; Laurie Stewart, President and CEO, Sound Community Bank, Seattle, Washington; Ignacio Urrabazo, Jr., President, Commerce Bank, Laredo, Texas; and Matthew Williams, Chairman and President, Gothenburg State Bank & Trust Company, Gothenburg, Nebraska. Committee Member Dorothy J. Bridges, President & CEO, City First Bank of D.C., Washington, D.C., was absent from the meeting.

Members of the Federal Deposit Insurance Corporation's ("Corporation" or "FDIC") Board of Directors present at the meeting were Sheila C. Bair, Chairman, Martin J. Gruenberg, Vice Chairman, and Thomas J. Curry, Director.

Corporation staff who attended the meeting included Steven O. App, Robert Basinger, Valerie J. Best, Erica F. Bovenzi, Michael Bradfield, Richard A. Brown, Jason C. Cave, Christine M. Davis, Diane Ellis, Robert Feldman, Jason K. Fincke, George French, Steven D. Fritts, Tiffany K. Froman, Mitchell Glassman, Tray Halverson, William F. Harral, Sally Kearney, Michael H. Krimminger, Ellen W. Lazar, Alan W. Levy, Roberta K. McInerney, Carol L. Middlebrook, Tariq A. Mirza, Arthur J. Murton, Paul Nash, Christopher J. Newbury, Richard Osterman, Silvia L. Ramirez, Claude A. Rollin, Lisa K. Roy, Jon T. Rymer, Walter C. Siedentopf, Christopher J. Spoth, Sandra L. Thompson, Jesse O. Villareal, Cottrel L. Webster, and James Wigand.

William A. Rowe, III, Deputy Chief of Staff, Office of the Comptroller of the Currency; was also present at the meeting.

Chairman Bair opened and presided at the meeting. She began by highlighting the importance of obtaining frequent input from community banks and giving a brief summary of the national economic situation. She then elaborated on the insight and information that the FDIC Board and staff hoped to gain from the meeting: 1) What improvements can be made to examination and supervision procedures that would help community banks survive and prosper through the current crisis; 2) What do community bankers think of the current financial legislation pending before Congress; and (3) What is the community bank reaction to the FDIC's prepaid assessment proposal and what suggestions do community bankers have for keeping the Deposit Insurance Fund ("DIF") industry funded.

Vice Chairman Gruenberg and Director Curry commented on the importance of community banks in leading the country out of the current economic crisis and the value of establishing a committee to foster communication with the community banking industry.

Paul Nash, Deputy to the Chairman for External Affairs and Designated Federal Officer for the Committee, and Christopher J. Spoth, Senior Deputy Director, Division of Supervision and Consumer Protection ("DSC"), opened the first discussion session on bank examination and supervision with an expression of appreciation for the role of community banks in solving the current crisis and of desire to hear about possible improvements to the examination process.

In the discussion that followed, regulatory flexibility was a central theme touched on by almost all Committee members. Most of the members cautioned against using "one-size-fits-all" regulation and asked for a case-by-case approach to examining and ensuring the safety of institutions. Committee Member Gray advised more flexibility in compliance timelines when rule changes are implemented, and Committee Member Schriefer suggested a more tailored approach to the requirements placed on banks by cease and desist orders. Committee Member Urrabazo pointed out that many examiners push banks to sell foreclosed property when it might be more beneficial to the bank and to the community for the bank to hold the property until market conditions improve. Committee Member Blanton cautioned that many times it is better to dispose of foreclosed assets early, but he also stated that examiners focus too heavily on improvement in quarterly earnings when a long term plan for improvement might be more prudent.

Committee Member Brown pointed out the importance of capital standards to the industry. Committee members Brown and Schriefer explained how increased capital requirements can affect the lending ability of a community bank, and Mr. Brown stated that meeting vigorous standards for Allowance for Loan and Lease Losses ("ALLL") while complying with increasing capital requirements is particularly difficult for community banks and undermines the prior planning of bank management. Mr. Brown and Committee Member Hopkins recounted how capital requirements in cease and desist orders are forcing many banks to sell off all of their best performing assets in order to come into compliance, and Mr. Blanton and Mr. Brown explained that the deadlines for meeting capital plan requirements are often unreasonable or impractical.

Many of the Committee members were also concerned about the treatment of specific types of assets under the current capital rules. Mr. Blanton and Mr. Urrabazo were concerned with the downgrading of performing securities and commercial real estate ("CRE") loans, especially during a time when there is an illiquid market for such assets; they suggested more flexibility in allowing markets to recover. Committee members Blanton and Cole expressed frustration with being required to write-down modified loans as troubled debt restructure when trying to proactively work with borrowers on loan modifications. Committee members Urrabazo and Rainey expressed concern over criticism of CRE lending and write-down of CRE loans by bank examiners, especially in communities where CRE represents a large proportion of potential business and the best opportunity for profitable loans.

Mr. Brown, Mr. Blanton, and Mr. Hopkins suggested that regulators could help institutions meet rising capital requirements by increasing the portion of an institution's ALLL that counts toward total capital.

Committee members Schriefer, Blanton, and Lewis all commented on the reclassification of performing loans based on a deterioration of value in the underlying collateral. They pointed out that many loans had been made based on cash flow and the underlying ability of the borrower to repay, separate from the value of the collateral, and that these loans have somehow been reclassified as "collateral loans" despite current payments by the borrower. Committee Member Miller explained that many appraisers are over-careful due to a fear of being criticized for failing to correctly value property that may later fall in value, leading to many reclassifications. Mr. Gray suggested creating a new examination category for loans that are performing but have underlying collateral values that have deteriorated.

Mr. Gray and Mr. Brown suggested that examiners review overall earnings, which can be dragged down by loan loss provisions, and operational earnings, which can give a better indication of how well a bank is performing structurally, separately.

There were also comments by Committee members Koch, Williams, and Gray regarding pressure placed on bank examiners and a disconnect between feedback given by examiners in the field and exam reports that come back from the FDIC regional offices.

Mr. Urrabazo commented on the difficulty that banks will have if congress limits fees associated with consumer bank accounts.

Mr. Urrabazo and Mr. Hopkins expressed frustration with being forced to reduce their institutions' reserve levels during better economic times, and Ms. Cole and Steven D. Fritts, Associate Director, DSC, pointed out that reserve drawdowns are required by the accounting standards set by the Financial Accounting Standards Board, not the FDIC.

Ms. Cole suggested that an extension of funds from the Troubled Asset Relief Program ("TARP") to community banks would help increase community lending. Mr. Schriefer expressed his frustration that the initial TARP program was reserved only for large banks, and he pointed out that the issuance of unused TARP funds could help to unfreeze capital markets and prevent costly failures in the future. Mr. Brown and Ms. Cole suggested that TARP funds be used as bridge loans for community banks in good financial condition, but Mr. Miller and Mr. Urrabazo cautioned that the public associates a stigma of "bailout" with institutions that receive TARP funds.

Committee Member Goodlock expressed frustration with the treatment, by examiners, of borrowing from the Federal Home Loan Banks ("FHLB"). Mr. Brown, Mr. Urrabazo, and Mr. Hopkins recounted that many banks have simply stopped borrowing from the FHLBs because of penalties and criticism from exam reports, and Mr. Miller pointed out that penalties associated with FHLB borrowing could drive up the cost of lending for community development projects.

Mr. Blanton expressed frustration with certificates of deposit ("CDs") over $100,000 not being treated as core funding; he suggested that this limit should be moved up to at least $250,000 to match the current deposit insurance coverage. Ms. Cole and Mr. Urrabazo pointed out that examiners would consider large CDs as core funding if the bank provides documentation proving that the deposits are stable.

Mr. Miller and Mr. Blanton expressed frustration over the negative treatment, by examiners, of brokered deposits, explaining that the real issue is what loans are being made rather than the funding. Mr. Williams pointed out that using brokered deposits and FHLB borrowing sometimes makes the best business sense.

Members of the FDIC staff, Richard A. Brown, Associate Director, Regional Operations, Division of Insurance and Research ("DIR") and Christopher J. Spoth, commented on the discussion, recounting what they saw as the major takeaways, and Steven D. Fritts assured the Committee members that the FDIC understands the difficulty of the current economic crisis and is actively considering ways to alleviate many of the mentioned issues. Mr. Fritts also explained that the FDIC would soon be issuing new guidance that should help in validating a bank's valuation and grading of its own loans.

Vice Chairman Gruenberg thanked the Committee members for their openness and commented that there were many takeaways from the meeting. He also commented that there were potential opportunities for an expansion of TARP lending to community banks.

Vice Chairman Gruenberg then called for a recess. Accordingly, at 10:21 a.m., the meeting stood in recess.

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The meeting reconvened at 10:38 a.m. that same day, whereupon Mr. Nash opened the second discussion session on financial reform legislation by asking for the Committee member's opinions on the proposed Consumer Financial Protection Agency ("CFPA").

Mr. Gray and Mr. Urrabazo stated that the new agency is not needed, that the FDIC already sufficiently regulates consumer issues for community banks, that it will impose an extra, unnecessary cost on community banks, and that community banks did not participate in the activities that the agency is intended to regulate. Mr. Blanton, Ms. Cole, and Professor Koch suggested that the new agency should regulate only the industry that has created the problem financial products. Finally, Mr. Gray, Mr. Hopkins, and Mr. Miller thanked the FDIC for its activism on this subject and asked how community banks can help.

Mr. Nash then explained that a recent change in the proposal would leave the CFPA as the unified rule maker for consumer protection but would leave regulation of smaller banks with the current regulator. Mr. Brown, Mr. Gray, and Mr. Goodlock commented that having a sole rule maker removes checks and balances and diminishes experience in the rulemaking process. Mr. Urrabazo expressed concerns over how a new rule maker would affect the Community Reinvestment Act.

Mr. Nash then asked if it would be easier to have the CFPA and the primary federal regulator examine at the same time. Almost all of the Committee members commented that this would be a drain on an institutions resources and time, and they characterized the joint exam with a single rule maker as a one-size-fits-all policy that does not address the real problem, the issuance of abusive and risky financial products.

Finally, Mr. Nash asked for comments on the proposal to do away with preemption of consumer protection laws, and the Committee members commented that this does not have a large impact on state chartered banks.

Next, Mr. Nash moved to the topic of a systemic risk regulator. Mr. Urrabazo suggested that the FDIC is sufficient to handle systemic risk. Mr. Goodlock and Mr. Hopkins stated that there needs to be an authority to handle systemic firms and that some of these firms should be dealt with under anti-trust laws. Mr. Williams pointed out that many systemic firms are not banks, and he expressed concern over having the FDIC involved in resolving non-bank firms. Chairman Bair interjected that even if the FDIC assisted in resolving non-bank firms, it would not guarantee liabilities of non-banks.

Mr. Nash next asked about the viability of the dual-banking system. Mr. Blanton pointed out that a state chartered bank has two distinct examiners, which is an advantage. Mr. Gray and Mr. Miller recounted some of the banking innovations that have come from state chartered banks, and Ms. Cole pointed out the growth in the community banking sector, even during a financial crisis. Mr. Williams, Mr. Blanton, Ms. Stewart, and Mr. Urrabazo pointed out that charter choice creates a more competitive environment. Mr. Hopkins and Mr. Goodlock expressed concerns over a single regulator losing sight of small banks, and they pointed out the inability of troubled institutions to switch charters.

Chairman Bair asked for opinions on requiring institutions to hold a new charter for a set time period before being allowed to change, and Mr. Hopkins expressed his support for the idea. Mr. Gray and Chairman Bair commented on the inconsistency in simultaneously removing federal preemption and eliminating the state charter.

Mr. Nash asked for opinions on the proposed elimination of the Office of Thrift Supervision and the thrift charter. Ms. Stewart acknowledged that there may be justification for consolidation of the OTS but did not believe that could be considered without a commitment to preserve the mutual charter.

Mr. Nash then asked whether something should be done to reduce the size of large banks. Mr. Hopkins suggested that more should be done to enforce state and federal deposit concentration caps, and Mr. Goodlock suggested separating the insured business lines of large institutions. Mr. Schriefer, Mr. Goodlock, Mr. Urrabazo, and Chairman Bair commented on the effect of financial sector deregulation and the possibility of un-winding the Gramm-Leach-Bliley Act, and Mr. Schriefer expressed frustration with allowing the creation of large bank holding companies. Professor Koch and Chairman Bair discussed evidence that economies of scale do not exist in large financial institutions. Professor Koch, Mr. Hopkins, Ms. Cole, Mr. Brown, Mr. Williams, Chairman Bair, and Vice Chairman Gruenberg discussed the possibility of charging an extra risk-based assessment for complex activity and providing for the resolution of complex firms in order to mitigate risk, ensure solvency, and facilitate orderly growth. Finally, Mr. Urrabazo commented that he feels capable of competing with big banks but that he does not like the idea of paying for their failure when they act irresponsibly.

Mr. Goodlock commented that the Securities and Exchange Commission's five hundred shareholder threshold limits the ability of community banks to merge.

Mr. Nash and Sandra L. Thompson, Director, DSC, asked Committee members for suggestions on using TARP funds to help community banks and for comments on the proposed dollar-for-dollar match of capital raised in the private market. Mr. Brown, Mr. Blanton, and Ms. Cole pointed out that matching would not work because the capital markets are broken. Mr. Hopkins pointed out that it would be difficult for family owned banks to participate in a match. Mr. Blanton suggested allowing bank holding companies to borrow and stream money to their subsidiary banks. Professor Koch voiced his support for the matching program, but he and Mr. Miller pointed out that provisions would need to be made for mutuals and S corporations.

Mr. Schriefer, Mr. Blanton, Ms. Cole, and Ms. Thompson discussed allowing banks with a CAMELS rating of 1, 2, or 3 to be automatically included in TARP eligibility and allowing the inclusion of banks rated 4 or 5 on a case-by-case basis. Mr. Schriefer, Mr. Blanton, Mr. Hopkins, and Mr. Nash discussed allowing all institutions to file applications for TARP funds, and they discussed which regulator would approve such applications. Mr. Miller and Mr. Urrabazo suggested that any program should be structured so as not to be identified with TARP, and Mr. Urrabazo requested that previous TARP borrowers be allowed to move into any new program.

Mr. Williams pointed out that the sale of failed banks is making it difficult to raise private capital, and he requested help from the FDIC on fighting overdraft protection proposals.

Vice Chairman Gruenberg then called for a recess. Accordingly, at 12:07 p.m., the meeting stood in recess.

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The meeting reconvened at 1:38 p.m. that same day, whereupon Paul Nash introduced Arthur J. Murton, Director, DIR, to open the discussion on the final topic, the funding of the deposit insurance system. Mr. Murton described the FDIC's proposed rule on prepaid assessments and opened the floor to comments from the Committee.

Mr. Brown and Mr. Blanton expressed approval for the prepayment rule, describing it as innovative and creative, and Mr. Gray approved of the proposed termination and refund date, which he said should mitigate any danger of over-assessment. In response to questions from Mr. Gray, Ms. Rainey, Mr. Goodlock, and Mr. Blanton; Diane Ellis, Deputy Director, Financial Risk Management and Research, DIR, and Chairman Bair explained how quarterly assessments and the 2014 refund would work under the proposed rule; they also explained that the rule is not final and is still out for comment. Mr. Hopkins, Professor Koch, and Mr. Murton discussed the reasons for needing three years worth of prepaid assessments, and Professor Koch and George French, Deputy Director, Policy, DSC, discussed the prepayment's potential affect on bank liquidity and ability to lend. Mr. Murton explained the FDIC's ability to exempt institutions that lack the resources to prepay, and Mr. Hopkins expressed concern that exemptions need to be kept confidential to avoid public panic. Finally, Mr. Urrabazo, Mr. Williams, Ms. Cole, Chairman Bair, and Ms. Ellis discussed the possibility of allowing institutions that so choose to expense their prepayments all at once rather than incrementally.

The Committee also discussed the assessment base for the various assessments. Mr. Schriefer, Mr. Urrabazo, Chairman Bair, and Ms. Ellis discussed the use of different assessment bases for the special assessment of May, 2009, the regular quarterly assessment, and the proposed prepaid assessment, and Ms. Roberta McInerney, Deputy General Counsel, Legal Division, explained that the FDIC has broad authority for structuring special assessments but that making changes to the regular quarterly assessment involves a more cumbersome process. Mr. Hopkins pointed out that times have changed and institutions no longer fund operation solely with insured deposits, and he suggested that switching to a regular assessment base of assets minus tier one capital would better capture the risk posed by an institution. Chairman Bair responded that the FDIC would consider a change in the regular assessment base, but she also stated that the Corporation would need to do a great deal of research and planning before any change could be made.

Mr. Murton explained the current balance of the DIF, and Mr. Miller, Mr. Blanton, Ms. Stewart, and Mr. Murton discussed the optics of a "negative" DIF balance and how to inform the public of the true status of the fund. Mr. Williams and Mr. Murton discussed the importance of keeping the DIF independent from other government funds, and Vice Chairman Gruenberg pointed out that Congress generally respects the independence of the DIF.

Mr. Murton also asked for the Committee's opinion on the use of counter-cyclical methods to fund the DIF. Mr. Urrabazo expressed support for maintaining high reserves during good economic times. Mr. Blanton and Mr. Miller expressed support as long as assessments are lowered at the appropriate times, and Mr.

Miller commented that new banks should not be exempted from assessments just because the DIF is fully funded during good times.

The Committee had a lengthy discussion on the FDIC's resolution process. After comments by Mr. Blanton, James Wigand, Deputy Director, Division of Resolutions and Receiverships ("DRR"), gave an overview of the FDIC's receivership process. Mr. Blanton, Chairman Bair, and Mr. Wigand discussed situations in which the FDIC had auctioned loans and participations for less than the workout offers that it had received. Mr. Brown asked if improvements were being made in workout negotiations, and Mitchell Glassman, Director, DRR, and Mr. Wigand responded that workouts can be difficult due to problems in obtaining early information on loans but that the process has been improving as the number of bank failures has increased.

Mr. Williams asked how many whole bank transactions the FDIC has entered into during this crisis, and Chairman Bair and Mr. Murton responded that 68 out of 98 failures have been resolved with whole bank transactions. Mr. Williams and Mr. Murton discussed the FDIC's loss rates on bank failures in the current crisis, and Mr. Urrabazo and Mr. Glassman discussed the FDIC's use of guarantors to mitigate losses. Mr. Williams stated that the FDIC often receives undue criticism for its losses during the resolution process.

Mr. Goodlock asked whether the FDIC could use loss share agreements to assist in the sale of open institutions, but Chairman Bair pointed out that the FDIC would need a systemic risk determination to provide financial assistance to an open institution.

Mr. Williams, Mr. Blanton, Chairman Bair, Mr. Glassman, and Mr. Wigand discussed the cost of FHLB loans during the receivership process, particularly the prepayment requirements on the loans, and they discussed methods for FHLBs and the FDIC to work together to reduce costs on FDIC receiverships. Mr. Miller expressed concerns over FDIC proposals to limit recovery by secured creditors during a failure, which he said would limit FHLB lending, and Chairman Bair explained that this proposal was targeted at the use of short-term collateralized liabilities and not at the FHLBs. Finally, Mr. Blanton, Mr. Miller, and Chairman Bair commented favorably on the increased use of collateral exams by the FHLBs.

Mr. Schriefer complimented the FDIC's increase in deposit insurance coverage, and Ms. Ellis stated that the first analysis of the program's effect would come out soon.

Chairman Bair asked if reducing the risk-weight associated with insured deposits would help community banks, and Mr. Blanton responded that anything that reduces capital requirements, even if just a little, would be helpful.

Finally, Mr. Hopkins and Mr. Blanton asked if the FDIC could speed up the execution of powers-of-attorney for the sale of assets.

Chairman Bair then asked for comments on the function of the Committee and what should be covered at subsequent meetings; she stated that she hoped the committee would meet quarterly. Mr. Gray approved of the format of the meeting, and Mr. Williams and Ms. Stewart approved of the FDIC's Washington office as a permanent meeting location. Mr. Schriefer and Mr. Blanton suggested bridge financing as a topic for the next meeting, and Mr. Urrabazo, Mr. Miller, and Chairman Bair discussed the circulation of a draft agenda thirty days prior to the next meeting. Finally, Mr. Lewis thanked the examination staff at his bank for giving good feedback and asked if he could share that feedback with the Committee at some future time.

There being no further business, the meeting was adjourned.

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
And Committee Management Officer
FDIC Advisory Committee on Community Banking

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I hereby certify that, to the best of my knowledge, the attached minutes are accurate and complete.

S C Bair

Sheila C. Bair
Chairman
Board of Directors
Federal Deposit Insurance Corporation

and

Presiding Officer
October 15, 2009, Meeting of the
FDIC Advisory Committee on Community Banking

Dated: January 13, 2010