FEDERAL DEPOSIT INSURANCE CORPORATION

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ADVISORY COMMITTEE ON COMMUNITY BANKING

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MEETING

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WEDNESDAY,
JULY 11, 2018

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The Advisory Committee convened at 9:00 a.m. in the Federal Deposit Insurance Corporation Board Room, 550 17th Street, N.W., Room 6010, Washington, D.C., Jelena McWilliams, Chairman, presiding.

PRESENT:

JELENA McWILLIAMS, Chairman, FDIC Board of Directors
MARTIN GRUENBERG, Director, FDIC Board of Directors
TIFFANY BAER PAINE, President & CEO, Security Bank USA
ADRIANA M. BOEKA, President & CEO, Americas United Bank
ASIF DAKRI, Vice Chairman & CEO, Wallis State Bank
CHRIS DONNELLY, President & CEO, Bank of the Prairie Olathe
DAVID J. HANRAHAN, SR., President & CEO, Capital Bank of New Jersey
DANNY J. KELLY, President & CEO, Hometown Bank of Alabama
ARVIND A. MENON, President & CEO, Meadows Bank
MARY ANN SCULLY, President & CEO, Howard Bank
JOHN M. TOLOMER, President & CEO, The Westchester

Bank
JOSEPH W. TURNER, President & CEO, Great Southern Bank
LEN WILLIAMS, President & CEO, People's Intermountain Bank

STAFF PRESENT:

RUTH AMBERG, Assistant General Counsel, Legal Division
LISA ARQUETTE, Associate Director, Division of Risk Management Supervision
RYAN BILLINGSLEY, Corporate Expert, Division of Risk Management Supervision
CHAD DAVIS, Deputy to the Chairman for External Affairs
DOREEN EBERLEY, Director, Division of Risk Management Supervision
DIANE ELLIS, Director, Division of Insurance and Research
GEORGE FRENCH, Acting Deputy Director, Division of Insurance and Research
MATTHEW GREEN, Associate Director, Division of Insurance and Research
M. ANTHONY LOWE, FDIC Ombudsman
JONATHAN MILLER, Deputy Director, Division of Depositor and Consumer Protection
RAE-ANN MILLER, Associate Director, Division of Risk Management Supervision
PATRICK MITCHELL, Deputy Director, Division of Insurance and Research
MARK PEARCE, Director, Division of Depositor and Consumer Protection
ROBERT STORCH, Chief Accountant, Division of Risk Management Supervision

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1 P-R-O-C-E-E-D-I-N-G-S

2 (9:02 a.m.)

3 CHAIRMAN MCWILLIAMS: Oh, good
4 morning, everybody. So, I am Jelena McWilliams,
5 I am the incoming Chairman at the FDIC, and this
6 is my first council meeting.

7 I am thrilled to be here. I am thrilled
8 to have you here. I spent a little bit of time at
9 the Federal Reserve and there was a bank advisory
10 council similar to this one, that one that provided
11 incredibly valuable perspective for a regulatory
12 agency.

13 So I was very pleased when I came to the
14 FDIC to learn that we have a very robust process
15 here. We have great members on the council, as
16 well. And the feedback we get from you enables us
17 to understand what's going on in your region, in
18 your areas, in the banking industry as a whole,
19 and, specifically, with respect to community
20 banks.

21 So I am just really happy to be here
22 today and to meet you and greet you to what is my

1 first meeting. And I think you are the only one
2 who is newer than I am to the council. The rest
3 are more experienced than us, but Marty will make
4 the introductory remarks and then we can start on
5 business. But welcome, everybody.
6 DIRECTOR GRUENBERG: Well, thank you,
7 Jelena. I promise to be brief. Let me just say
8 that this committee was actually started when
9 Sheila Bair was chairman of the FDIC, and then was
10 continued when I became chairman. And for the
11 committee to meet today under the leadership of our
12 new chairman I think is really a very positive
13 statement about the particular responsibility that
14 the FDIC has as lead federal supervisor for the
15 majority of community banks in the United States.
16 And the commitment of this agency to
17 sustain a strong community bank sector in the U.S.
18 financial system, frankly, from our perspective,
19 is very much in the public interest to have the
20 strong community bank sector in the United States.
21 And I think this committee, in some
22 measure, symbolizes this agency's obligation and

1 commitment in that area. And I think it's also
2 fair to say, as Jelena pointed out, this committee
3 has proved exceptionally valuable to the work we
4 do. It really is a vehicle for us on a regular
5 basis to engage with community bankers. We tell
6 you what we're doing, and we get feedback from you
7 in return. And there's been a lot of value to that,
8 and I think it's impacted the work we do in multiple
9 ways.
10 So, let me say I really view it as a very
11 -- as a statement, the continuation of this
12 committee is a statement of the FDIC's commitment
13 to community banking. And I'm really very pleased
14 that our new chairman is, in effect,
15 institutionalizing this committee as part of the
16 work of the FDIC. Thank you.
17 CHAIRMAN MCWILLIAMS: Thank you. All
18 right, we can start with the legislative update,
19 please.
20 MR. DAVIS: Okay.
21 CHAIRMAN MCWILLIAMS: And actually,
22 can I just make the introduction real quick? So,

1 Chad Davis is Deputy to the Chairman for External
2 Affairs. He just started about a week and a half,
3 two weeks ago almost?
4 MR. DAVIS: Week and a half.
5 CHAIRMAN MCWILLIAMS: Week and a half
6 ago. So he is slightly more senior than you and
7 I. Still slightly more junior than I am at this
8 job. And Chad and I worked together on the Senate
9 Banking Committee on different legislation. And
10 he then worked with the Federal Reserve.
11 So we snagged him from the Federal
12 Reserve. And his job is going to be exactly this
13 type of an outreach effort that the FDIC engages
14 in to understand what's going on with our banking
15 industry and our regulated entities. So, thank
16 you, Chad.
17 MR. DAVIS: Thank you, Chairman
18 McWilliams. We thought we'd begin this morning by
19 providing the committee with a summary of the
20 Economic Growth, Regulatory Relief, and Consumer
21 Protection Act, which was enacted on May 24th.
22 I thought it would be appropriate to

1 focus on some key aspects of the law and its impacts
2 on community banking.
3 Ruth Amberg, Assistant General Counsel
4 in our legal division, will begin the discussion.
5 Rae-Ann Miller, who is an Associate Director in the
6 Division of Risk Management Supervision, will
7 touch on issues such as examination frequency,
8 reciprocal deposits, and appraisals.
9 Ryan Billingsley, corporate expert on
10 capital markets, will talk about the impact on the
11 capital rules as well as the Volcker Rule.
12 Bob Storch, the FDIC's Chief
13 Accountant, will touch on Call Report matters.
14 And lastly, Jonathan Miller, Deputy
15 Director in our Division of Depositor and Consumer
16 Protection, will discuss issues related to the Home
17 Mortgage Disclosure Act, the qualified mortgage
18 rule, and escrow requirements.
19 I'll now turn the program over to Ruth
20 who will kick things off.
21 MS. AMBERG: Thank you, Chad. And
22 good morning, everyone.

1 So, as Chad said, our panel today is
2 going to be discussing the Economic Growth,
3 Regulatory Relief, and Consumer Protection Act.
4 And as he noted, it became law on May 24th. The
5 act includes a number of provisions that may be of
6 particular interest to this committee.
7 Some key provisions of the Act were
8 addressed by the FDIC, the OCC, and the Federal
9 Reserve Board in an interagency statement which was
10 issued last Friday. That interagency statement is
11 in your packets. It's also on the FDIC's website.
12 The statement sets forth some of the
13 positions that the agencies are going to be taking
14 in the interim until the agencies have a chance to
15 amend our regulations to incorporate changes to the
16 various statutes that stem from the new law.
17 So, for example, the statement covers,
18 among other matters -- these will be discussed more
19 by our experts here -- it will be discussing the
20 increase in the threshold for eligibility for an
21 18-month examination cycle for qualifying banks.
22 And that threshold, as you know, had been $1 billion

1 in total assets and now has been raised to $3
2 billion.
3 The statement also covers the plans for
4 additional actions, such as for implementing the
5 reduced Call Report requirements for the first and
6 third quarters for certain banks.
7 It also covers the exemption to
8 appraisal requirements for qualifying rural
9 transactions, a. And the changes to high
10 volatility commercial real estate.
11 Furthermore, the Act changes the scope
12 of the coverage for the Volcker Rule and the
13 treatment of certain municipal obligations as
14 high-quality liquid assets for purpose of the
15 liquidity coverage ratio rule.
16 And basically, as I said, it sets forth
17 the interim positions that we're going to be going
18 over while we work on amending our rules and take
19 other actions to implement the Act.
20 So, you'll also find in your packets,
21 and on our website, a financial institution letter
22 that we issued about the Home Mortgage Disclosure

1 Act. So, that's something that Jonathan is going
2 to be discussing, as you noted.
3 So, because Chad has already introduced
4 the panel, I think we'll get started with them.
5 And then after each presentation we'll have some
6 time for questions and discussion and see how we
7 get through.
8 So, Rae-Ann, do you want to --
9 MS. MILLER: Sure, I'll start. Thanks
10 a lot, Ruth. So, I'm going to talk about exam
11 cycle, appraisals, and reciprocals. And, as Ruth
12 said, I'll pause if anybody wants to ask questions.
13 So the new law, and we call it around
14 here S-2155, because the long name is kind of hard
15 to say and it sounds a little like EGRPRA when you
16 use the acronym.
17 But, basically, the new law
18 automatically raises the eligibility threshold for
19 an 18-month examination cycle for institutions
20 with assets from $1 billion to $3 billion. And
21 that's provided that they're well managed, well
22 capitalized, not subject to an enforcement action,

1 and not subject to a recent change in control.

2 So what we're talking about here are the

3 1-rated institutions that's automatically

4 affected. It also authorizes the agencies to

5 adopt regulations to do this same change for

6 essentially 2-rated institutions. So it's sort of

7 the same deal, that they have to be 2-rated, they

8 have to meet the other qualifying criteria of being

9 well capitalized, not subject to an enforcement

10 action, not subject to a change in control.

11 So, at this time, we're sort of

12 discussing amongst the agencies, since this would

13 require an action on our part, what's the best way

14 to move forward with that.

15 We'd also point out, it doesn't affect

16 folks in this room, but we do have some foreign

17 branches that this also affects.

18 And another important thing is that the

19 law gives us a great deal of latitude to authorize

20 the 18-month threshold. And the flip side of that

21 is to require institutions to still continue on the

22 12-month cycle. So it retains our authority to do

1 that.

2 So, that's the exam cycle. Appraisal

3 exemption. So, this one deals with transactions

4 in rural areas. And so, it's effective

5 immediately. And certain real property in rural

6 areas are exempted from the appraisal requirements

7 that are set forth in Title XI of FIRREA.

8 So, this applies to transactions under

9 $400,000, it applies to properties located in rural

10 areas, and the rural area definition is the same

11 definition that's used in Reg Z.

12 To get this exemption, the mortgages

13 have to be held in portfolio, and the following

14 conditions have to be met. So, I have to read these

15 because I can never remember them, but: not later

16 than three days after the consumer receives the

17 closing disclosure required under Reg Z, the

18 mortgage originator or its agent, directly or

19 indirectly must have, number one, contacted not

20 fewer than three licensed or certified appraisers

21 on the mortgage originator’s approved list in the

22 market area and documented that no state- licensed

1 or certified appraiser was available within five
2 business days. And that's beyond the customary
3 fee. So maybe you could have gotten somebody but
4 had to pay way out of the range, but that doesn't
5 count.
6 So, the exemption, again, we have
7 pretty wide latitude from the supervisory
8 perspective. It doesn't apply if we require an
9 appraisal for safety and soundness reasons.
10 The exemption also doesn't apply if the
11 loan is a high-cost mortgage. And if you remember,
12 Dodd-Frank Act revised TILA to define what a
13 high-cost mortgage is, and that sort of overrides
14 the appraisal regulations when a high-cost
15 mortgage is in place.
16 So, again, we're sort of looking at this
17 right now. It's effective immediately. But
18 we're looking at our appraisal regulations to see
19 whether we need to do some conforming regulations.
20 Those two conditions are pretty
21 specific and aren't currently, obviously,
22 addressed in our regulations, so we'll need to take

1 a look at those.
2 And then moving on to reciprocals,
3 again, effective immediately, institutions that
4 are well capitalized and have a composite condition
5 of outstanding or good, and so that means a one-
6 or two-rated institution as of their last
7 examination, or that have obtained a brokered
8 deposit waiver from the FDIC, don't have to report
9 reciprocal deposits as brokered on their Call
10 Reports.
11 So, as long as reciprocal deposits
12 don't exceed a certain cap, and the cap is defined
13 as 20 percent of the institution’s total
14 liabilities or $5 billion, whichever is less.
15 So, the exception is also available to
16 IDIs that are not well capitalized and not in
17 outstanding or good condition.
18 But the qualifying reciprocal deposits
19 for these institutions would be capped at an
20 average of how many reciprocals were held during
21 the last four quarters, since the IDI was well
22 capitalized or was rated a two or better. Or the

1 general cap, whichever is less. So they could be
2 subject to a more stringent cap.
3 Since most community banks fall within
4 this limit, most reciprocal deposits will
5 accordingly no longer be treated as brokered
6 deposits for the Call Report. Reciprocal deposits
7 that exceed that amount will be considered brokered
8 deposits.
9 And, one other limitation here, which
10 is a very important one, is that the exemption does
11 not apply when funds have been obtained through an
12 agent, either an agent institution or traditional
13 deposit broker or some other third party.
14 Also important is that less than well
15 capitalized institutions qualifying for this
16 exemption are still subject to the rate
17 restrictions. So any deposit that is obtained
18 after a bank falls below well capitalized is
19 subject to those rate restrictions. Reciprocals
20 are no exception.
21 And, again, these provisions are
22 effective immediately. We're looking to see

1 whether we need to actually make any conforming
2 changes to our brokered deposit regulation.
3 Unlike appraisals, brokered deposit is
4 our regulation, not an interagency regulation. So
5 I think I will stop there and see if anybody has
6 any questions. Okay.
7 CHAIRMAN MCWILLIAMS: Any discussion?
8 Okay.
9 DIRECTOR GRUENBERG: Wait a second,
10 I'll ask --
11 CHAIRMAN MCWILLIAMS: You made
12 everybody speechless.
13 (Laughter)
14 MS. MILLER: So exciting.
15 MS. AMBERG: All right, so, well, if
16 you think of something, we'll have time later. So,
17 Ryan, do you want to go on to the Capital and Volcker
18 provisions?
19 MR. BILLINGSLEY: Sure. So let's talk
20 a little bit about Capital and Volcker. I will
21 talk about two capital issues in the Act and then
22 will briefly touch on Volcker.

1 So I'll start with Section 201
2 entitled, Capital Simplification for Qualifying
3 Community Banks, otherwise affectionately known
4 here as the Community Bank Leverage Ratio.
5 So, I'm going to briefly describe kind
6 of what it says. And then I'll try to sort of head
7 off some questions that we've received already. ,
8 to the best of my ability. I can't answer
9 everything.
10 So, this provision of the Act applies
11 to banks with consolidated assets less than $10
12 billion. And there's also a risk profile
13 consideration.
14 The Act states that the banking
15 agencies may determine that a bank, less than $10
16 billion, is not qualifying based upon its risk
17 profile. And the Act outlines what we are supposed
18 to look at when we make that determination.
19 And those things include, one: 1) off-
20 balance sheet exposures, two,2) trading assets and
21 liabilities, three,3) total notional derivative
22 exposures, and number four,4) kind of a catchall,

1 it says, other factors as the banking agencies may
2 deem appropriate.
3 The leverage ratio is required to be set
4 between eight and ten percent. And the ratio would
5 be defined as tangible equity divided by average
6 total consolidated assets.
7 A banking organization that chooses to
8 use this framework would be deemed compliant with
9 all of the capital requirements. So that has
10 implications for things like Call Report
11 simplification.
12 You can imagine a bank that looks to use
13 this, not having to fill out the RC-R schedule
14 today.
15 The Act also instructs the banking
16 agencies to sort of work or consult with the
17 applicable state banking supervisors, which we
18 will do.
19 Just real quick, a couple of questions
20 that we've already received, which I don't think
21 I can answer but just to let you know that these
22 are things that are sort of top of mind here.

1 So the Act says, tangible equity
2 divided by average total consolidated assets.
3 Well, one question is, "What do you mean by tangible
4 equity?"
5 One can think of several different
6 definitions for that. So, we are working on that,
7 and that's going to require a rulemaking.
8 The other wrinkle is the Act requires
9 a ratio between eight and ten. Well, that's
10 obviously a little bit of a range there.
11 I don't have an answer for you about
12 today, where we're going to land on that, but that's
13 something we're thinking about, as well.
14 And then the risk profile
15 considerations, we're thinking about those, as
16 well. They obviously have implications for
17 applicability of the ratio for banks under $10
18 billion.
19 So, let me stop on that one now and see
20 if there is any questions on the community bank
21 leverage ratio before I go too far.
22 MEMBER HANRAHAN: I have a comment not

1 a question, Ryan.
2 MR. BILLINGSLEY: Sure.
3 MEMBER HANRAHAN: I urge the
4 Ccorporation to consider the bottom end of that
5 range, the eight percent end of that range, as it
6 sets that standard.
7 Madam Chairman, I listened to your
8 testimony during your confirmation process and I
9 was very heartened to hear your emphasis on
10 community banks, the need to slow the rate of the
11 decline of the number of community banks in the
12 country.
13 And fostering more de novos is one way
14 to do that. I think the easier and more efficient
15 way of doing that is slowing the ones going out the
16 back door who are choosing to sell.
17 And for those of us who run
18 stockholder-owned banks, our primary objective is
19 to generate a return for our stockholders. The
20 idea of selling naturally becomes more attractive
21 if we can't generate satisfactory returns on equity
22 to our own stockholders.

1 And one way of doing that is leveraging
2 our capital. And an eight percent ratio is going
3 to be much more conducive to us generating returns
4 that really cover cost of capital for our
5 stockholders.
6 And I think that while the Ccorporation
7 might, well, by nature there is some additional
8 level of risk, the more you leverage your capital.
9 At the same time, if it's the FDIC's objective to
10 keep as many community banks alive in the country
11 as possible, allowing us to leverage capital,
12 allowing us to generate the sort of returns we need
13 to for stockholders and, therefore, remain
14 independent, goes a long way to keeping the maximum
15 number of community banks running in the country.
16 CHAIRMAN MCWILLIAMS: Thank you.
17 Thank you, Dave. That's actually a very valuable
18 insight for us, thank you. Anybody else.?
19 MR. BILLINGSLEY: Okay, moving on. So
20 the next item for me is Section 214, titled,
21 Promoting Construction and Development on Main
22 Street, otherwise known as High Volatility

1 Commercial Real Estate.
2 So, the Act provides a definition for
3 HVCRE ADC, for purposes of the risk-based capital
4 rule. It can effectively, sort of supersede the
5 existing regulation.
6 And I know there was a proposal that we
7 put out that included definition of HVADC. It kind
8 of supersedes that, as well.
9 The interagency statement that went out
10 on Friday provided some guidance for how banks can
11 categorize HVCRE on their Call Report. So let me
12 just summarize that really quickly.
13 It basically says the banks are
14 permitted to use the Act’s definition of HVCRE when
15 they report in the second quarter.
16 For Call Reporting purposes, it's not
17 an obligation to do that. If you feel you don't
18 have the information or otherwise don't feel
19 comfortable, you can continue to report on the
20 regulation’s definition, which is perfectly fine.
21 And again, it will be a best efforts
22 basis, realizing you may not have the best

1 information today.
2 So that's sort of the interim step for
3 application of this provision of the Act.
4 Obviously, we will have to go back to our
5 regulations, sort of a different rule, to make sure
6 that it aligns with the Act.
7 We've gotten a lot of questions about
8 specific terms within the Act's definition, like,
9 "What do they mean? How would you like us to apply
10 that?" At this point, we have to sort of wait, --
11 think through that with the other agencies for the
12 rulemaking process to do that.
13 So, I think it's, at this point, it's
14 just a best efforts basis to apply the definition
15 as you see appropriate. Vis-a-vis the Call Report
16 until we sort of iron out those details. So I will
17 stop there on the HVCRE, . If there are any
18 questions, I'm happy to address them.
19 MEMBER TURNER: So, what are the
20 differences between the new definition and the old
21 definition?
22 MR. BILLINGSLEY: There are a lot.

1 So, I can point out a few.
2 So, the new definition in the act states
3 that an HVCRE exposure must be secured by land or
4 improvedimroved real property. That's sort of a
5 difference from the current rule.
6 The new definition in the act states
7 that the credit facility sort of primarily finances
8 or refinances the ADC of real property. That kind
9 of aligns with the HVADC definition that we
10 proposed, but not with the existing regulation.
11 There are some exemptions in the Act for
12 things like cash-flow generating properties,
13 income-producing improved real estate. So, think
14 of improvement loans. The use of improvement
15 loans to an income-generating property, we might
16 extend a construction loan.
17 And then there is, in the existing HVCRE
18 definition, there is a requirement that there be
19 15 percent contributed capital. I think you're
20 all familiar with this one.
21 The Act allows the appraised value of
22 land contributed by the borrower to count toward

1 that 15 percent. So those are some of the key ones.
2 And again, we'll work through all the
3 clarifications, if necessary, through the
4 rulemaking process. Anybody else?
5 MS. AMBERG: Can you repeat all that?
6 (Laughter)
7 MR. BILLINGSLEY: There will be a test
8 later. So, the last thing, this will be quick, is
9 the Volcker Rule.
10 So, the Act effectively exempts IDIs or
11 affiliates of IDIs with total consolidated assets
12 of $10 billion or less and trading assets and
13 liabilities of five percent or less than total
14 assets from the Volcker Rule.
15 The only caveat is that if you're
16 controlled by a larger institution you have to
17 continue to apply the Volcker Rule. I think that
18 one is fairly straightforward.
19 The interagency statement indicates
20 that we're not going to enforce the Volcker Rule.
21 The -- 2015, found the Volcker Rule in a manner
22 inconsistent with the statute, so it effectively

1 means that community banks under $10 billion are
2 exempted from the Volcker Rule.
3 I think that one is fairly
4 straightforward. Any questions on any of that,
5 I'm happy to address it.
6 MEMBER SCULLY: I have a question.
7 Any sense of how many banks, under $10 billion, are
8 engaged in those kinds of activities?
9 MR. BILLINGSLEY: I think today the
10 five percent, I'm assuming you're referring to the
11 total trading assets and liabilities of five
12 percent?
13 MEMBER SCULLY: Yes.
14 MR. BILLINGSLEY: Yes. I think today
15 the answer is, if you're a community bank under $10
16 billion, that five percent trading asset and
17 liability sort of prong doesn't matter. It just
18 kind of creates like a, maybe an up or down of what
19 you could do to maintain exemption, if you will.
20 MEMBER SCULLY: Yes, my sense is that
21 the Volcker Rule is appropriately, of a much
22 greater concern to non-community banks than to

1 community banks. So it's good to know that but I
2 don't know how many banks are engaged in that kind
3 of activity or now will be engaged.
4 CHAIRMAN MCWILLIAMS: Oh, interesting
5 question.
6 MEMBER SCULLY: It would just be
7 interesting to know as you follow it --
8 MR. BILLINGSLEY: Sure.
9 MEMBER SCULLY: -- to see if it does
10 make a difference in the behavior of --
11 MR. BILLINGSLEY: Absolutely.
12 MEMBER SCULLY: -- the organizations.
13 CHAIRMAN MCWILLIAMS: And, Ryan, you
14 have a number, I think, at least the neighborhood,
15 for the number of names that would be excluded?
16 MR. BILLINGSLEY: It's effectively all
17 of them under $10 billion, so it's a little over
18 5,000.
19 CHAIRMAN MCWILLIAMS: A little over
20 5,000, that's right.
21 MR. BILLINGSLEY: But, there's a few
22 under that that may be affiliated with a much larger

1 institution. But, yes.

2 MS. AMBERG: Anything else on capital

3 or Volcker? Okay, Bob, you're going to talk about

4 the Call Report.

5 MR. STORCH: Okay, thank you, Ruth.

6 Section 205 of the Act, I'll give you the complete

7 name like everyone else has avoided it.

8 (Laughter)

9 MR. STORCH: Come up with whatever

10 acronym you want for it I suppose. Section 205

11 directs the federal banking agencies to issue

12 regulations that allow for a reduced reporting

13 requirement in the Call Reports for March and

14 September for covered depository institutions.

15 And the law defines covered

16 institutions as insuredinsured depository

17 institutions that have less than $5 billion in

18 total assets and satisfy other appropriate

19 criteria established by the agencies.

20 As you may know, the FFIEC and the

21 banking agencies introduced a streamlined FFIEC

22 051 Call Report in March of 2017 for eligible small

1 institutions as part of the FFIEC's community bank
2 Call Report burden reduction initiative. And for
3 that purpose, eligible small institutions,
4 generally are institutions with domestic offices
5 only, and less than $1 billion in total assets.
6 Those institutions have the option to
7 file the FFIEC 051 report form or to continue to
8 file the otherwise applicable FFIEC 041 report
9 form.
10 The streamlined FFIEC 051 Call Report
11 already has embedded within it, reduced reporting
12 requirements in the first and third quarters for
13 about 200 data items in the entire report. And for
14 the first quarter 2018 Call Report, about 76
15 percent of the approximately 5,000 eligible small
16 institutions chose to file the FFIEC 051 Call
17 Report.
18 Prior to the enactment of the new law,
19 the FFIEC, through its Task Force on Reports, have
20 begun exploring alternatives for expanding FFIEC
21 051 eligibility beyond the initial $1 billion asset
22 size threshold. And this effort included the

1 review of Call Report data submitted by
2 institutions with more than $1 billion in total
3 assets, that could serve as a basis for a proposed
4 FFIEC 051 eligibility criteria for certain larger
5 institutions.
6 So, some of the groundwork to support
7 the rulemaking that's required by Section 205 has
8 already been in process.
9 So, if we focus on the $1 to $5 billion
10 asset size range, which is the size limit specified
11 in Section 205 as I mentioned, there are currently
12 about 530 institutions in that size range that a
13 reduced reporting requirement could potentially
14 apply to, because those banks currently are filing
15 the FFIEC 041.
16 Since Section 205 was enacted, the
17 FFIEC Task Force on Reports has begun interacting
18 with the agency's legal staffs in terms of possible
19 implementation issues that would need to be
20 considered in the rulemaking process.
21 The Task Force on Reports, in
22 consultation with the various users of Call Report

1 data within the FFIEC member entities, will also
2 be considering how the reduced reporting
3 requirements currently in place in the FFIEC 051,
4 can be extended to the additional institutions,
5 while continuing to meet the agency's critical data
6 needs and any existing data reporting requirements
7 mandated by other laws.
8 Ryan mentioned the Section 201 of the
9 new law that provides for that community bank
10 leverage ratio for qualifying community banks.
11 And that has the $10 billion size limit, whereas
12 the Section 205 reduced reporting requirements
13 applies at, up to the $5 billion size limit.
14 So there's a partial overlap between
15 whatever potential reduced reporting requirements
16 there may be for community bank leverage ratio
17 purposes and Section 205.
18 So, one of the considerations going
19 forward for the agencies, with the Section 205
20 rulemaking and the proposed additional reduced
21 reporting requirements, will be the need to ensure
22 the appropriateness of reporting frequency for

1 those Call Report data items that working with the
2 capital policy staffs are determined to be needed
3 to assess the risk profile, the risk profile
4 considerations that Ryan mentioned, to determine
5 which institutions under $10 billion should be
6 qualifying institutions for community bank
7 leverage ratio purposes.
8 And with that concluding, sort of tie
9 into another section that Ryan covered, I'd like
10 to open up to discussion or your questions.
11 MEMBER TOLOMER: I think it's been
12 helpful that you've reduced a little bit, but the
13 reality is, for a community bank that's really just
14 a community bank with a very simple straightforward
15 approach to business, it's still an 86, 87 page
16 report.
17 It has 15 pages on capital and our
18 capital isn't really complex because we're not
19 utilizing derivatives and the like. So I'd like
20 to see more work done for real true community banks
21 to reduce, it takes three days.
22 I asked my CFO of our bank and he said,

1 we've got a very experienced
2 controllercomptroller, takes him two days to do
3 this work, and then it takes him another day to do
4 it. -- to review it and to post it.
5 So we're talking about three full days
6 to report information that's available. We're
7 sensitive that you want information, that's great,
8 but streamlining it at 88 pages isn't streamlining
9 it. I think I'd like to see more done for the
10 community bank that really is not involved in
11 different types of businesses, we're different.
12 And it's a burden. And I think for
13 banks that are even smaller than our bank, it's even
14 more of a burden. And I know that some of my
15 colleagues on the Committee feel strongly that way,
16 as well.
17 So, just it’s input, I'd like to see for
18 community banks, even more work done to reduce the
19 amount of work that is required.
20 MR. STORCH: Yes, I would point out
21 that the, actually the 051, with the reductions
22 that were put in place, is down to like 61 or 62

1 pages. It's still a lot of pages.

2 MEMBER TOLOMER: Right.

3 MR. STORCH: Fifteen pages of that, as

4 you suggest, is the regulatory capital.

5 MEMBER TOLOMER: Right.

6 MR. STORCH: So, to the extent your

7 institution would be eligible, after the

8 rulemaking process is completed for the community

9 bank leverage ratio, arguably, what, it would be

10 two items maybe instead of 15 pages. So that would

11 be a big savings.

12 And I think the FFIEC Task Force on

13 Reports recognizes that that's probably the

14 biggest area where burden reduction could be

15 achieved, but it depends on rulemaking. But we're

16 not going to sit on what we've already done so far.

17 MEMBER TOLOMER: Okay.

18 MR. STORCH: There is recognition that

19 we need to consider what additional burden

20 reduction there can be beyond just the capital, to

21 satisfy what Section 205 asks for.

22 MEMBER TOLOMER: Okay.

1 MR. STORCH: And any proposals for
2 reduced reporting, do go out for industry comment.
3 And we do consider the comments we receive.
4 MEMBER TOLOMER: Okay.
5 MEMBER SCULLY: Yes, I'm just going to
6 kind of echo what David said in this light of how
7 many pages will be eliminated if we choose the
8 simpler leverage ratio.
9 I think since any of us that have,
10 certainly institutional investors or shareholders
11 interested in a return, a number of us certainly,
12 we are strongly considering not taking that
13 simplicity leverage because we feel that we can
14 better manage our capital if we stick to the
15 risk-based formulas.
16 So, I wouldn't necessarily anticipate
17 that a lot of people will rush to that simpler ratio
18 because simpler, if it's inefficient for our
19 investors, isn't necessarily the best thing.
20 MR. STORCH: I think it would be
21 interesting to know as well, from your investor
22 perspective, whether the level of detail that's

1 required now, in schedule RC-R, if you opt to
2 continue that path, whether there could be some,
3 even reduction, less frequent full reporting
4 there, but would still meet the needs of your Board
5 and your investors.
6 MEMBER SCULLY: That's a very
7 predictable response.
8 (Laughter)
9 MEMBER SCULLY: It's going to be very
10 helpful. I mean look, 15 pages of anything just
11 raises the probability of a mistake or an error
12 somewhere along the way. So any sort of reduction
13 in the theme of all of this, in paperwork, is going
14 to be helpful.
15 But I would just caution that I think
16 a lot of smaller banks are going to choose not to
17 take that simpler ratio. Because the risk-based
18 ratio, while itsit’s complicated, provides you
19 with more of a proactive opportunity to manage your
20 capital. bBy choosing how you would allocate your
21 assets.
22 MR. STORCH: Not to put you on the spot,

1 this is just myself asking personally --
2 MEMBER SCULLY: Okay.
3 MR. STORCH: -- would there be any
4 benefit to sort of doing a side work paper
5 calculation of the risk-based capital under the
6 standards to provide your investors, even if you
7 opt for the community bank leverage ratio, for Call
8 Report and other purposes?
9 MEMBER SCULLY: No, probably not. I
10 mean, that's work that we're all doing right now
11 anyways. --evaluating whether this is a practical
12 opportunity or just a theoretical opportunity.
13 So, it's appreciated that it's
14 suggested but, no, I don't think it would be a
15 meaningful aid.
16 MS. MILLER: Hey, Bob, can I pipe in one
17 second, because I think Mary Ann raises a good
18 point, is there is more users to the Call Report.
19 You know, your shareholders, analysts whenever we
20 cut items or change items, public analysts, you
21 know, we hear from them.
22 And another thing is, the stuff I was

1 talking about, about exam frequency, that 18 months
2 is not guaranteed. I mentioned, we have lot of
3 flexibility to not grant that.
4 Well, one thing that we do is we look
5 at the Call Report and we try to analyze, what has
6 been in the changes in the institution since the
7 last exam to determine whether or not to extend that
8 exam cycle. So it's sort of a balance.
9 Understanding your point, John, about
10 cutting burden, but it is also a tool that we use
11 to make other decisions.
12 MEMBER DAKRI: Do we have numbers of
13 how many banks are actually using the short-term
14 Call Report?
15 MR. STORCH: Yes. There are about
16 5,000 eligible institutions from March, at 76
17 percent. So it's like in the 35, 3,600. That's
18 just a quick, from what I recall, seeing the data.
19 The ones that are not anecdotally, from
20 what we've heard, and this may not be, the universal
21 reason is, the banks that are getting close to the
22 billion-dollar threshold and they don't want to go

1 to the 051 and then have to very soon go back to
2 the 041. They want to keep their reporting systems
3 in place.
4 Or they're part of a larger
5 organization that has to file a consolidated FR
6 Y-9C with the Fed. And the Fed wants, the banking
7 organization wants the detail from each
8 institution to roll up into the consolidated
9 numbers.
10 So those are a couple of the reasons
11 that we had heard individual institutions who are
12 otherwise eligible, chose not to file the 051 and
13 continued with the 041. But I'm sure there are
14 other reasons as well.
15 MEMBER DAKRI: And just a real quick
16 follow-up. Is there any plans to maybe extent
17 extend that short form to the other quarters?
18 Quarters 2 and 4.?
19 MR. STORCH: Well, the minimum
20 requirement on the section is the first and third
21 quarters. The agencies, through the FFIEC, did
22 try to reduce the overall level of detail that's

1 recorded.

2 So there were certain schedules that
3 were entirely eliminated from the 051. And just
4 some very high-level data to serve as sort of a red
5 flag in a supplemental schedule was included in the
6 051 as a replacement for about five or six
7 schedulesschedules that had previously existed.

8 So there was an effort to reduce overall
9 reporting throughout the year, in addition to the
10 about 200 items where we already have either
11 semi-annual or annual reporting, again, to reduce
12 some of the burden on institutions.

13 MEMBER DAKRI: Thank you.

14 MEMBER BAER PAINE: We actually are
15 still using the 041 because the difference, time
16 difference in the shortened form, really was not
17 much at all. So for the consistency of the
18 reporting it would be really nice, we're a $145
19 million bank, so it would be nice for us to take a
20 look at, in that first and third quarter, really a
21 true reduction in that Call Report, bringing it down
22 to the balance sheet.

1 The RC, RI, RC-C schedules, just really
2 simplifying those, those first and third quarters.
3 Because at this point they're just not, the new
4 schedules aren't practices that we have in place.
5 So it didn't help us much at all.
6 MEMBER DONNELLY: You know, I would
7 concur with that. We're in the same boat and same
8 size and the value of the reduction didn't make a
9 lot of sense. We didn't get much value out of it
10 and maintain the same level or maintain the same
11 throughout each quarter.
12 I think it does provide a value to us
13 internally so the reduction didn't really do much
14 at all.
15 MEMBER TURNER: I want to go back. I
16 think, Ryan, you talked about capital and the
17 simplified capital.
18 One of the biggest changes to the
19 risk-weighted capital rules, to me occurred, or to
20 our institution, occurred a couple of years ago when
21 you had to start including all of your unfunded
22 commitments in your risk-weighted assets.

1 And so if you do elect this sort of
2 simplified tangible asset, tangible capital,
3 tangible asset ratio, obviously unfunded
4 commitments would be completely ignored, right, for
5 that purpose?
6 Or is there something where you're going
7 to measure unfunded commitments for institutions,
8 and if they're too large in relation to your asset
9 size then you won't qualify for that?
10 MR. BILLINGSLEY: So that's a great
11 question. T, this is where I dodge.
12 MEMBER TURNER: Okay.
13 (Laughter)
14 MR. BILLINGSLEY: So, you read the rate
15 and know how good I am.
16 So, I talked about the risk profile to
17 sort of carve out, if you will, in the legislation,
18 it says that when we assess the risk profile we may
19 deem a bank under $10 billion sort of,
20 non-qualifying for the community bank leverage
21 ratio based upon certain factors. And one of them
22 is off balance sheet exposures.

1 MEMBER TURNER: Yes.
2 MR. BILLINGSLEY: So, there have been
3 no decisions made, so I can't really address that
4 directly. But we could, I guess is we could,
5 consider those types of things when we do make that
6 determination, but there have been no decisions
7 made on that at this point.
8 MEMBER TURNER: Okay. And that would
9 be true even if a bank is one rated, for instance,
10 or you just don't know yet?
11 MR. BILLINGSLEY: I don't know yet.
12 MEMBER TURNER: Okay.
13 MR. BILLINGSLEY: It's a great question
14 and it's one we're sort of wrestling with right now.
15 MEMBER TURNER: Okay.
16 MR. STORCH: And unfunded commitments
17 are reported in a separate schedule for off balance
18 sheet activities already today, separate and apart
19 from all the risk weighting that has to be done for
20 it.
21 MEMBER TURNER: Right. Right.
22 MS. AMBERG: Okay, anything else on --

1 MEMBER BOEKA: I will be responding
2 with my colleagues here that the finance department
3 decided to continue with the same as before. It was
4 not worth making it, all those changes.
5 So, it didn't do the trick for, but on
6 the other hand, we did not have a complaint. After
7 so many years, it was pretty automated for a simple
8 bank of small size.
9 MR. MILLER: All right, if there are no
10 other questions we'll go to the fun stuff now.
11 (Laughter)
12 MR. MILLER: So, good morning. The
13 focus of my presentation, as Chad and Ruth
14 mentioned, is going to be on the title, some of the
15 provisions in Title I of what I have been referring
16 to as the Crapo Act, after the Senator who authored
17 the provision, the bill in the Senate.
18 And so specifically, I'm going to look
19 at Section 101, which is the minimum standards for
20 residential mortgage loans which creates a new type
21 of qualified mortgage.
22 And Section 108, escrow requirements

1 related to the mortgages. And both those are
2 changes to the Truth in Lending Act.
3 And the Section 104, which is the
4 changes to HMDA. Which I know will have a pretty
5 big impact on many of the institutions that we
6 supervise.
7 So let me start with the ATR/QM. --
8 the ability to repay QM rules.
9 So, under the ATR rule, the ability to
10 repay rule, creditors must consider a consumer's
11 ability to repay a loan according to its terms for
12 all closed-end mortgage transactions.
13 The qualified mortgage designation was
14 basically a simplified way, sort of a checklist of
15 things you could do that would establish with a
16 creditor right away that the loan meets the CFPB’s
17 ability-to-repay test.
18 Within the, again, this has been sort of
19 the pre-Crapo Act, although it continues to exist,
20 a small creditor definition. To meet the small
21 creditor definition, you had to have assets of $2.1
22 billion as of 2018. It was $2 billion in the

1 statute and then it’s adjusted annually.

2 That counts the assets of both the

3 creditor and its mortgage affiliates. And you will

4 have had to have sold fewer than 2,000 loans first

5 lien originations.

6 You can, no limit on the amount of

7 mortgages you could hold on your portfolio and

8 retain a small creditor designation.

9 If you are designated as a small

10 creditor, that gives you the benefit of making loans

11 that qualify for QM status without the bright line

12 deposit debt to income. The 43 percent

13 debt-to-income test that's in the standard QM.

14 And small creditors that make at least

15 one loan into a rural area get the rural

16 designation. That allows them also to make balloon

17 loans that were considered to be QM. , which

18 non-rural, non-small creditors do not get that

19 ability.

20 And also, a much broader safe harbor for

21 small creditors under the QM test. So that's the

22 law and the regulation pre-Crapo.

1 Now, all that continues under the Crapo
2 Act. But the Crapo Act really, it doesn't alter or
3 supersede those regulatory standards for those
4 types of qualified mortgages,. What it really
5 does, so, practices that were in compliance prior
6 to the Act passing are still in compliance.
7 What it does do is it adds an additional
8 type of qualified mortgage. And for insured
9 depositories and credit unions only. So this is,
10 this does not apply to non-bank mortgage lenders.
11 And the key amendments, the key changes
12 are that, whereas the old threshold was $2 billion
13 as adjusted, the new threshold is now $10 billion.
14 $10 billion in consolidated assets, not just the
15 assets of the bank and the mortgage affiliates. --
16 the consolidated assets. --the loans.
17 So, if you are under $10 billion
18 consolidated assets, you qualify for this
19 additional type of qualified mortgage as long as the
20 loans are in compliance with respect to pre-payment
21 penalties, for which the points and fees do not
22 exceed three percent of the total loan amount.

1 No NegAM or interest-only features. So
2 the features that proved to be particularly
3 problematic in the market as the crisis arrived.
4 And for which the bank has considered
5 and documented the debt, income and financial
6 resources of the consumer. And the loans have to
7 be held on portfolio for the life of the loan.
8 So this frankly addresses one of the key
9 concerns I think we heard from many community banks.
10 And so, now any loan that they hold on portfolio
11 going forward, will, as long as it meets those other
12 underwriting criteria, will qualify as qualified
13 mortgages.
14 And there are a couple of slides in your
15 packet that might, this is what the cover looks
16 like. It might just be worth taking a quick look
17 at it.
18 So, in fact, the CFPB's old QM rule
19 really covered most of the FDIC-supervised
20 institutions already, as this chart shows you.
21 Already about 2,300 of our banks already have less
22 than $10 billion in assets.

1 The additional FDIC-supervised
2 institutions that we think will now be eligible to
3 make mortgages that meet, that qualify this for this
4 new qualified mortgage category, is about 191. So,
5 about 191 new institutions that made 1.2 percent of
6 all reported mortgages by number, which is the first
7 chart, and by dollar volume, which is the next slide
8 that you see.
9 Obviously, a higher percentage of
10 mortgages made by FDIC-supervised institutions.
11 But in the market, as a whole, it's probably not
12 going to be an awfully big impact. The rule had
13 really already accommodated most community banks.
14 Certainly most of the community banks
15 that we supervise. Although I think this does
16 cover a few additional institutions and gives them
17 a little bit more certainty.
18 Any questions on the QM?
19 So the next thing I want to cover briefly
20 is escrow accounts. So, again, prior to the Crapo
21 Act, the law and the regulation required the
22 establishment of escrow accounts for all

1 higher-priced mortgage loans. HPMLs we call them.
2 We really need an acronym for everything.
3 There were allowances for cancellation
4 after a certain period of time and so forth, but
5 there were key, for our institutions, key
6 exemptions to the escrow requirement.
7 And that was, again, for small creditors
8 operating in rural or underserved areas, designated
9 as small rural creditors, they really, they were
10 exempt from the escrow requirement as long as they
11 met a certain other criteria. For example, they
12 could not have an escrow program in place.
13 So, if they had not traditionally
14 escrowed for mortgages, these institutions, they
15 would not have to start escrowing for HPMLs as well.
16 If they did have an escrow program in
17 place, then even though they were smaller
18 institutions operating in rural areas they would
19 have to continue to do that.
20 Under the Crapo Act, similarly similar
21 to the QM and some of the other provisions you heard,
22 the designation for small creditor goes from $2

1 billion as adjusts to $2.1 billion up to $10
2 billion. And again, the loan has to stay on
3 portfolio.
4 There is one other distinction that we
5 have not yet sort of figured out how it will affect
6 the number of institutions for whom, for which this
7 benefit is available.
8 Under the old rule, you not only had to
9 be small rural but you also had the -- you didn't
10 sell more than 2,000 first lien dwelling secured
11 transaction, dwelling secured loans. And the
12 criteria now is, you don't originate more than a
13 thousand loans secured by a first lien on a
14 principal dwelling.
15 So, I think that's just going to be an
16 empirical question which we've not answered yet,
17 how many of our institutions fit in that. I would
18 say our typical, the typical FDIC institution
19 originates somewhere in the neighborhood of 100
20 first lien mortgages a year.
21 So, I suspect the new provision will
22 cover almost all our institutions. Just like the

1 QM did.
2 MEMBER SCULLY: You know, the tricky
3 think about qualifying, is dwelling secured though,
4 is that you're going to pick up investor real estate
5 as well as typical one to four residential.
6 MR. MILLER: Right. So the new rule
7 is, the new law, the new provision is principal,
8 principal dwelling. Right.
9 Now, HMDA, Home Mortgage Disclosure
10 Act. So, the coverage under the pre-Crapo HMDA
11 rule.
12 So, all IDIs that met the longstanding
13 asset size, location, federally related tests and
14 a minimum loan activity test, had to report HMDA.
15 The IDIs that meet the origination threshold, now
16 this was changed by the HMDA rule that went into
17 effect in the first half of, the first part in 2017.
18 The more detailed part went into effect the first
19 of this year.
20 The threshold went up from just making
21 one loan to at least 25 closed-end mortgage loans
22 in the previous two years. This is the pre-Crapo

1 standard.
2 And the pre-Crapo standard also
3 introduced a requirement for HELOCs, or open-end
4 lines of credit of at least 500, in two years in a
5 row. That change alone actually reduced the number
6 of FDIC-supervised institutions reporting HMDA.
7 Approximately five to 600 institutions.
8 The Crapo Act now goes much, much
9 further. So, the Crapo law provides a partial
10 exemption from reporting certain data fields to
11 some of the insured depository institutions and
12 insured credit unions.
13 So the threshold now goes from 25 first
14 lien loans two years in a row or closed-end loans
15 two years in a row to 500 mortgages. Closed-end
16 mortgages in each of the two proceeding calendar
17 years.
18 And for open-end lines of credit it
19 retains the, it puts into statute the, what the CFPB
20 had established in regulation that required if the
21 institution originates fewer than 500 open-end
22 lines of credit in each of the proceeding two years

1 the exemption applies.
2 However, it does not apply if for the
3 past, the last two CRA evaluations the institution
4 received a performance rating of needs to improve
5 for CRA or, and that's for two cycles in a row needs
6 to improve, or if in the previous, the last CRA
7 evaluation, it received a performance rating of
8 substantial noncompliance.
9 Both of those are pretty rare. And
10 typically, if somebody is receiving a substantial
11 noncompliance, for example, it's because one of the
12 reasons is they're just not making mortgage loans
13 and to get, needs to improve two cycles in a row,
14 which is likely to be a three- or four-year cycle.
15 It's just unlikely.
16 I mean, I would use the term de minimis.
17 And I would not expect anybody here to really have
18 to worry about that.
19 Note that the Act does not, this is an
20 important point. I think there has been some
21 misunderstanding on this. These new thresholds,
22 the 500 loans, closed-end or open-end, just exempts

1 you from certain of the additional fields that were
2 required. Reporting fields required in the
3 Dodd-Frank Act.
4 You continue, if you're above the 25 and
5 below the 500, you still have to report the other
6 HMDA fields. And there has been some
7 misunderstanding about that.
8 I will say parenthetically and
9 editorially that we're grateful for that because,
10 as the Deputy for Research and Policy, we like the
11 data. And in fact, it's quite helpful to us in our
12 supervisory, in our supervisory process.
13 So, now the sort of, to tap dance a
14 little bit with my partner Ryan there, as clear as
15 that sounds, we're going to have to wait for the CFPB
16 to issue some rules to tell us exactly which fields
17 have to continue to be reported and which fields do
18 not.
19 There were some that are fairly clear,
20 total points and fees, loan channels, such as retail
21 or broker, credit score and so forth, that will no
22 longer have to be reported. But, it's not as simple

1 as going back to the old fields because in part of
2 its rulemaking, the CFPB changed around the old
3 fields somewhat.
4 So, it's not clear how the act
5 affectsAct affects that. There were some fields
6 that were added by Dodd-Frank that were not
7 explicitly eliminated in the Crapo Act, so those may
8 have to still be reported.
9 And then there were a couple of fields
10 that the Federal Reserve, using its rulemaking
11 authority, added to the list beyond what this
12 original HMDA statute had listed. And it's not
13 clear how the Crapo Act will affect that.
14 So, we are in touch with the FFIECFFIEC
15 agencies are working together on this. It's really
16 the CFPB's call, it's their rule.
17 They've promised to put out a, and we've
18 put out a, as Ruth indicated, and again, in your
19 package, we put out a financial institution letter
20 which made clear that the CFPB is intending to put,
21 do some rulemaking this summer to clarify some of
22 these things so that people will understand, fairly

1 quickly, what has to be collected and what doesn't
2 have to be collected.
3 And just to close, if you'll turn to the
4 last slide in our package, so you'll see this really
5 has quite a dramatic impact on FDIC-supervised
6 institutions, in terms of the number of
7 institutions, and less of an impact in terms of the
8 amount of lending it covers.
9 So you'll see, so only 244
10 FDIC-supervised institutions will be required to do
11 the full HMDA reporting going forward. They make
12 about 71 percent of the mortgages by number and
13 nearly 76 percent by volume.
14 So we've reduced the burden on a lot of
15 banks without necessarily losing a lot of the
16 information that's valuable to us. Thank you.
17 MEMBER KELLY: If I might speak to that.
18 We're about 350 million, and we're a classic
19 community bank. We loan on houses and cars. And
20 we are dangerously close to 500.
21 And I got some data from my compliance
22 folks where we were doing 26 fields per loan.

1 That's 117 fields per loan.
2 I realize that you like the data, but
3 that's a lot of difference. And I'd really like to
4 know what usefulness there is to that 90 fields or
5 whatever per loan.
6 You know, when you're doing, I mean,
7 we're at like 485 or something and we're doing
8 everything in our power to describe the loan
9 correctly such that it doesn't apply. But, anyway,
10 no, we're not going to do that really.
11 But it's a number we watch real closely.
12 And when I first saw the information I sent a text
13 to my compliance person and said, "Hey, oh happy
14 day," and she said, "Wait just a damn minute -
15 (Laughter.)
16 MEMBER KELLY: -- not such a happy day."
17 And I think the clarity is really critical. I mean,
18 because 26 to 117 makes a material difference in a
19 bank our size.
20 MR. MILLER: So just to be clear, the 26
21 to 117, it's not quite an apples-to-apples
22 comparison. But, notwithstanding, I mean, we're

1 not the rule maker here --
2 MEMBER KELLY: I understand.
3 MR. MILLER: -- and it's not the law.
4 So --
5 MEMBER KELLY: I just say, put as much
6 pressure as you can on the CFPB, let's get this thing
7 straight so that we can start doing 26 instead of
8 117.
9 MEMBER HANRAHAN: I'm going to use
10 Danny's oh happy day line in my question.
11 (Laughter.)
12 MEMBER HANRAHAN: So, Jonathan, as you
13 know from an email I had with, email exchange I had
14 with Mark a couple of days ago, what I thought was
15 good news for my bank, which is nowhere near 500
16 loans, when we went over the HMDA changes with our
17 compliance consultant, which is a national
18 compliance consultant whose name you would
19 recognize, they said, "Well, you have been relieved
20 of the reporting requirements of the expanded data,
21 but we're not so sure you've been relieved of the
22 collection requirements of the report data because

1 what if you get a needs to improve or a substantial
2 noncompliance in CRA, you better have that data to
3 report."
4 I'm curious to hear FDIC's position,
5 please.
6 MR. MILLER: Well, let me start by
7 saying thank you for letting us know in advance
8 about the question and -- it gave us a chance to look
9 it over.
10 (Laughter.)
11 MR. MILLER: From our point of view, we
12 do not think the law requires you to collect the data
13 if you don't have to report it. It's completely up
14 to you whether you want to do it for whatever
15 internal purposes, fair lending or other purposes.
16 As an exam matter we would not, we would
17 just have nothing to -- if you're not reporting the
18 data, we would not expect you to collect the data.
19 And they just avoid getting a "needs to improve" two
20 times in a row.
21 (Laughter.)
22 CHAIRMAN MCWILLIAMS: Jonathan, can

1 you maybe elaborate a little bit how we are going
2 to look at fair lending issues in general if the data
3 is not collected?
4 MR. MILLER: Well, again, remember all
5 the old -- nothing changes for us in how we do any
6 of our exams pre-2018 because there were no
7 additional data fields in pre-2018, so we'll still
8 have the old data.
9 We'll still be collecting the old data,
10 and we'll still be doing the same kind of analysis
11 we have always done.
12 So, for example, if there is a red flag
13 on pricing, so there is an indication based on the
14 old HMDA data, I'll just say that term, that
15 pricing, which does not include some of the fields
16 that the new HMDA data includes that you would want
17 to know, for example FICO score.
18 If there is a red flag, we talk to the
19 bank. We collect the additional data on a
20 case-by-case basis if there is a red flag, and then
21 we do the analysis.
22 CHAIRMAN MCWILLIAMS: Does that

1 satisfactorily answer your question?
2 MEMBER HANRAHAN: Yes, that does, and
3 your earlier comments did as well. We are going to
4 DVR this webcast and show it to our compliance
5 consultants, so you know.
6 (Laughter.)
7 MEMBER HANRAHAN: I will, since you
8 brought up fair lending, Madam Chairman, I will make
9 a general comment. We are really grateful for the
10 relief that community banks got under S.2155.
11 One of the things that has been
12 discussed over time that would also be of, I
13 believe, material relief to community banks related
14 to fair lending is the requirement that if FDIC
15 observes an apparent violation of fair lending that
16 it is obligated to refer that to the Department of
17 Justice.
18 That seems draconian, and it has a
19 chilling effect on our desire to treat consumers
20 flexibly and perhaps make exceptions sometimes to
21 loans, because once you make an exception for
22 somebody then if you haven't made that exact same

1 exception to somebody else it's a compliance
2 minefield.
3 I don't know if the requirement to refer
4 apparent fair lending violations to Justice is a
5 legislative matter or a regulatory matter. To the
6 extent it is something the FDIC can do something
7 about, that would be a material way to create some
8 relief for inadvertent non-systemic fair lending
9 violations.
10 MR. MILLER: So it is in the statute,
11 it's in the law, and I would say we -- I think we
12 understand that community banks, the strength of
13 community banks is the flexibility that they have.
14 I think we encourage community banks to
15 use that flexibility, but we just say to them
16 monitor it because if you do start seeing
17 exceptions, if you start seeing a systematic
18 pattern in the exceptions that has a fair lending
19 implication, then that's worrisome.
20 So I would also just say we have so few
21 referrals as a percentage of our total exams that
22 it's just useful to keep that in mind.

1 CHAIRMAN MCWILLIAMS: And there you see
2 Mark behind Jonathan. He doesn't need the break at
3 10:15, so just feel free to grab him.
4 MR. DAVIS: So part of my role is the
5 timekeeper. We do have about seven more minutes.
6 I thought I would suggest if anybody wanted to move
7 back up the panel as well, you know, pretty much I
8 think over the next few minutes any question,
9 relevant question, is fair game. So I just thought
10 I would give people an update on where we stood time-
11 wise.
12 MEMBER DONNELLY: Just a general
13 question on the appraisals and the appraisers, and
14 being from Kansas and then from also, not -- I'm not
15 from western Kansas where there may be one or two
16 people in the whole county not appraisers --
17 MS. MILLER: It could be an appraiser
18 though, you don't know that.
19 MEMBER DONNELLY: We are finding that
20 it's really difficult, and the timeframes that is
21 really a short, trying to make a determination if
22 you can find somebody, and you may have to call four,

1 five, or six counties away, which is further than
2 all these states put together.
3 I think there has got to be some
4 assessment as to the reality, what value somebody
5 can bring from four, five, six counties away, which
6 could be 150 or 200 miles, what value is that over
7 the person who is there in that community making
8 that loan, been there for 20 years, and understands
9 the value.
10 I am just making a general comment
11 because that is a significant issue we hear
12 constantly from our small banks in Kansas, and it's
13 getting worse instead of better.
14 Finding somebody who wants to be a
15 certified appraiser or licensed or whatever rule
16 you follow within your state and within the
17 guidelines is not going to improve, and I make that
18 statement as that I really think the FDIC ought to
19 look at really, I hate to say loosening up, because
20 we don't want to lose safety and soundness, that's
21 not what the point is.
22 It's just a matter of fact there is

1 nobody out there to do it and to have too restrictive
2 of timeframes or when you have to move to do certain
3 things I think is going to be really difficult for
4 the small banks out there.
5 MS. MILLER: Yes, I mean we talk to a lot
6 of, and thanks for that, because we do talk to a lot
7 of rural bankers. In fact, we did a listening
8 session at the end of last year.
9 We did not go to Kansas, but I had the
10 pleasure of going to both North Dakota and South
11 Dakota in November.
12 MEMBER DONNELLY: It's the same thing.
13 MS. MILLER: And it was kind of cold.
14 But, yes, so we hear that, and availability is not
15 improving.
16 There is a few things, supply of
17 appraisers is sort of being depressed by the, I will
18 say one banker called it the guild-like nature of
19 the appraiser profession where you train your
20 competitors, so who wants to do that?
21 And if you are the only guy in that place
22 in Kansas, well then you've got it pretty good

1 because you can get all the work you want. So they
2 talked about that and supply, and asked us to look
3 at the balance of supply and demand.
4 And so I am going to talk a little bit
5 later about raising the threshold, which we
6 recently did on the commercial side which should
7 provide some relief.
8 So if there is no demand for a licensed
9 or certified appraiser to do that, then that is
10 helpful. We can't do a heck of a lot about supply
11 because that is a different industry that we don't
12 regulate. So there is that.
13 You know, there are other things that we
14 have talked about. There are waiver options in
15 rural areas, you know, we've had one case of that.
16 We did not, the Appraisal Subcommittee did not
17 approve that, the case wasn't made, but certainly
18 something that we are thinking about.
19 The provision in S.2155, it's written in
20 an interesting way, and that's why I read it is --
21 it's hard to kind of understand, but I think it's
22 trying to attempt to give an exemption to those

1 rural folks.

2 So if the property is located in a rural
3 area you have to call three people, and then you get
4 five days to try and say, “Well I can't find anybody
5 in five days,” so I think it was an attempt to
6 provide relief, but it's going to be challenging for
7 us looking at it and figuring out what kind of
8 regulations we will need to write, if any.

9 MEMBER DONNELLY: So in general on that
10 assessment, if I have a loan today that I make and
11 I use the exemption, three months from now I may have
12 another loan on the piece of property right next
13 door and I have to go through the same -- we already
14 know because the environment has not changed, so
15 it's a per-unit process versus an overall
16 assessment of the environment, which that seems to
17 be a little silly. Sorry.

18 MS. MILLER: No, I don't -- yes, I
19 didn't write S.2155, but, yes, it's something we'll
20 talk about later, too, about the overall thresholds
21 and what is the appropriate balance.

22 You talk about safety and soundness,

1 another thing about when we said a threshold, it
2 doesn't mean that the bank doesn't value the
3 property, so stuff that happens underneath the
4 threshold you should be getting evaluations, you
5 should be knowing --
6 MEMBER DONNELLY: Sure.
7 MS. MILLER: But one thing when we write
8 rules is we're not just writing for the good guys,
9 you know, we have to write for everybody and make
10 sure that safety and soundness is appropriate
11 across the system.
12 So, very good points, ones we have heard
13 in EGRPRA, on these outreach sessions, and
14 certainly some of the briefings we have done for
15 this group as well.
16 MEMBER DONNELLY: One more question.
17 Jonathan, I would like to go back to your comment
18 about data, we like data. On the HMDA reporting a
19 thought, or your thoughts, on the differential
20 between owner- occupied, where I am actually
21 owning, versus a rental property, investor
22 property. Our HMDA is maybe 20 percent

1 owner-occupied versus --
2 MR. MILLER: Oh, is that right, your --
3 so only 20 percent of yours is --
4 MEMBER DONNELLY: It's probably even
5 less than that. Whether there is a real person
6 living in it, and they are all real people, but the
7 differential, what does the Ccorporation see as a
8 differential when you are talking about data,
9 you're talking about hard data, and you're using it
10 for something, and I sure understand that.
11 MR. MILLER: So I think part of it is for
12 exam analytics, that is what's, you know, what are
13 the, are we seeing, you know, if there's a problem,
14 if there is a red flag is there really a problem
15 there, and the vast majority of the times it turns
16 out there is not a problem.
17 And the other is just to understand what
18 is going on in markets as a way of sort of improving
19 our supervisory planning and just understanding the
20 market so we inform ourselves better as to what we
21 need to be doing.
22 MEMBER DONNELLY: Well, I would -- my

1 comment is just that, and I know you don't make that
2 rule, that's in another shop, if there is a
3 distinguishing between those that would be a real
4 burden reduction if there is some logic or if you
5 could find some logic to share with the other
6 agencies.
7 If you could distinguish between from
8 where I sit on my side of the desk there is a
9 significant difference between an owner-occupied
10 property and an investor property.
11 Now the person in that is once the --
12 when I make the owner-occupied loan I am dealing
13 directly with that individual. The individual who
14 is in that house I am one removed when it's an
15 investor.
16 So if there is other data you are
17 collecting for that third party, if there is a
18 reason, I don't know if that makes sense, and I don't
19 know what that is, but I think if you would look at
20 those and really separate the two I think the
21 reduction of burden would be reduced significantly.
22 MR. MILLER: We'll take a look.

1 CHAIRMAN MCWILLIAMS: You know, this is
2 your first meeting, right.?
3 (Laughter.)
4 MEMBER DONNELLY: Does that mean I
5 should shut up?
6 MR. DAVIS: Okay.
7 CHAIRMAN MCWILLIAMS: Taking notes.
8 MEMBER DONNELLY: Thank you.
9 MR. DAVIS: I have to wave the
10 timekeeper flag. Thank you very much to the panel.
11 We will take a brief break now. Be back in this room
12 at 10:30, and we'll have a couple more panels for
13 you at that point. Thank you.
14 (Whereupon, the above-entitled matter
15 went off the record at 10:17 a.m. and resumed at
16 10:33 a.m.)
17 MR. DAVIS: Okay, I think we'll go ahead
18 and get started.
19 CHAIRMAN MCWILLIAMS: See this is why I
20 need a gavel.
21 (Laughter.)
22 MR. DAVIS: In our next session, we

1 would like to provide an update on other regulatory
2 burden reduction initiatives. Our panel is from
3 the Division of Risk Management Supervision.
4 We have Doreen Eberley, the Director,
5 Rae-Ann Miller, an Associate Director who oversees
6 the Risk Management Policy area, and Lisa Arquette,
7 the Associate Director who oversees our Anti-Money
8 Laundering Group.
9 They are going to discuss exam
10 modernization and related standardized process for
11 the FDIC to obtain imaged loan files
12 electronically.
13 We will also have the opportunity to
14 talk more about appraisals, and we will highlight
15 reviews of interagency guidance as well as Bank
16 Secrecy Act.
17 So I will turn it over to Doreen to get
18 us started.
19 MS. EBERLEY: Okay, great. Thank you.
20 So the four kind of initiatives that we are talking
21 about here today, exam modernization, the
22 interagency guidance review, the work on

1 appraisals, the appraisal regulation and
2 regulatory relief there, and the Bank Secrecy Act,
3 all are coming out of the EGRPRA review from last
4 year.
5 So in the report that we submitted to
6 Congress last March we said that we weren't done,
7 we were going to continue our efforts to look at how
8 we may be able to provide continuing burden
9 reduction relief through the regulatory process
10 through our examination processes.
11 So that's what we are talking about
12 today, and I will go ahead and turn it over to
13 Rae-Ann to kick us off.
14 MS. MILLER: Thanks very much, Doreen.
15 So I thought I would start with exam modernization
16 with this group.
17 We had talked about exam modernization
18 I think in the Spring 2017 session, and we did a
19 facilitated discussion and really kicked off the
20 project because that's right about when we started,
21 and we got a lot of great feedback from this group.
22 So just as a very quick background,

1 Doreen talked about the EGRPRA report, and we
2 started this project, and say exam modernization,
3 exam modernization is an interagency project
4 through the FFIEC, and what we are trying to do is
5 figure out ways to improve the efficiency and
6 streamline the -- exam process really without
7 sacrificing the quality of the exam.
8 And we are talking about safety and
9 soundness exams for the most part here, although
10 some of the principles we are talking about
11 certainly could apply to other types, and we are
12 talking about community banks as well, so just to
13 take a step back there.
14 And in the EGRPRA process, the process
15 was about our regulations and, you know, we
16 published regulations for comment and had the
17 outreach sessions that some of you participated in,
18 but we also got a lot of comments about it's not just
19 regulations but it's the actual process of the
20 examination when you are on site and the
21 communications that occur that also can lead to
22 concerns about burdens amongst community bankers.

1 So we started this project after the
2 EGRPRA report was delivered, and we started out
3 focusing on three different areas, and, again, this
4 is sort of in the safety and soundness realm.
5 So the first was reviewing exam
6 practices and processes, and there we had a goal of,
7 a particular goal of determining whether technology
8 can be used to make the exam activities that we do
9 already more efficient, and specifically, could we
10 conduct more of the work that we do on an offsite
11 basis.?
12 Secondly, we reviewed the format of the
13 report itself, and are there opportunities to
14 improve the quality and usefulness of the reports?
15 And then, thirdly, we looked at the
16 Uniform Bank Performance Report and related reports
17 and data to see whether we could make them more
18 informative, more user-friendly.
19 So we have a group that is made up of
20 folks like me from the other agencies. I am the
21 Chairperson of the group, and started, you know,
22 staffing the project and overseeing these areas.

1 And we also linked up with a separate
2 group that we have called the Task Force on
3 Surveillance Systems, and they were already
4 pursuing a track to improve the Uniform Bank
5 Performance Report.
6 And I said something earlier about the
7 Call Report, one of the things we do with the Call
8 Report is it feeds into these surveillance systems
9 that we use, and Chris was interested in what do we
10 use the data for, and there is macro uses to see what
11 is happening in certain areas, in asset classes, in
12 changes in risk profiles in general, growth, but
13 from a micro perspective, we look at institutions
14 and see how they change in between examinations.
15 And so we have a number of early warning
16 systems and surveillance systems, this group helps
17 us with that and it helps standardize that process,
18 but it does help in our exam scheduling and work that
19 we do around assessing risk profiles.
20 So the project is long-term and
21 multi-phased. Here we are over a year into the
22 project, but we didn't want to wait to make

1 improvements till the end so we have kind of been
2 doing stuff on a flow basis.
3 So our initial step was getting
4 together, comparing practices among the agencies,
5 we sought some initial feedback from bankers and
6 examiners, and we definitely talked to this group,
7 as I mentioned, but we also spoke to individual
8 bankers, eight individual bankers, and about 50 or
9 so more through trade group associations.
10 They held the calls and asked questions
11 that we would be interested in, and we sort of
12 listened in.
13 So we got a number of themes from those
14 feedback sessions, and the most common theme, I
15 don't think you'd be surprised because I hear it
16 here, and the comment came from this side, but I
17 think it was Danny or maybe Mary Ann made this
18 comment about, you know, communications -- it
19 sometimes can be a black hole, I think was the word.
20 I hated that word, but, you know, we heard it again,
21 that sometimes bankers don't understand why we send
22 so many people to the bank, you know,. Who are all

1 these people, ? what What are they doing.?
2 Did you actually read the stuff that we
3 gave you beforehand, because it doesn't seem like
4 you did, -- this three examiners -- they are
5 laughing, see. But these are the things that we had
6 heard, you know, three people asked me the same
7 question.
8 And then what happens to the exam
9 report? Do we send it to the office? We are very
10 anxious, . We want to see what that says. You gave
11 me a preview, but you also said that the regional
12 office could change it, so we would like to know.
13 One of our bankers talked about how in
14 production you can track things along, you know, has
15 it gone into the factory, is it going down the path,
16 and suggested a process like that for us.
17 We like to think about the pizza making,
18 right, you know, . Are they adding the pepperoni,
19 ? Are they putting it in the car, ? You know,
20 could there be something like that to track the exam
21 report was literally something that somebody
22 suggested.

1 So there was that, that was sort of the
2 first theme. The second theme was we specifically
3 asked the bankers and examiners about the benefits
4 of moving more activities offsite, and both sides
5 were very enthusiastic.
6 To a person, almost, except for one on
7 the bankers, they really did value the onsite
8 presence and having those conversations and being
9 able to chat with the examiner who has been in many
10 different institutions.
11 They talked about the benefits of having
12 informal communication and understanding that, you
13 know, if we talk about trends and things, it doesn't
14 mean a direction to do something, but it's something
15 that the bankers felt were appropriate.
16 From the examiner's perspective, they
17 talked about picking things up. You know, if you
18 are at a bank and you are trying to evaluate
19 management or the way they do something, sometimes
20 you just pick things up on the way the bank is
21 operated when you are onsite.
22 So, we are not talking here about

1 completely moving everything offsite, that we find
2 an extreme benefit of being onsite.
3 The third theme was sort of a lack of
4 belief that we truly risk- focused our exams. And
5 based on risk profile and business model, so John
6 talked about being a plain, old, you know, community
7 bank, we have community banks that have been around
8 since the 1800s, and pretty much have done the same
9 thing for many, many years, and so I mentioned that,
10 hey, I am sort of a poky little bank in the middle
11 of nowhere and yet you turn 60 percent of my loans
12 every year, why do you do that, and so they felt
13 that.
14 From the examiner's perspective, the
15 examiners felt that we do a good job probably of
16 scoping up, but could probably do a better job and
17 giving them cover to do a more basic baseline,
18 especially for those very low risk institutions.
19 So I think that was very helpful to hear.
20 And I think another thing that we heard
21 a lot about were complaints about the secured file
22 transfer systems that we use, and ours is called

1 FDIC*connect*, but the other agencies have them, and
2 we had a lot of comments about functionality and
3 slowness and then there is nobody to call.
4 So we have all kind of done our own, we
5 have our own system, so we have been at least trying
6 to improve functionality on FDIC*connect* on the back
7 end.
8 One of the things was that sometimes
9 examiners were using it as a storage facility when
10 it is a transfer facility. So having, you know, ten
11 exams in there really will slow things down if you
12 are trying to bring things over. So we think we
13 have at least worked on some of that stuff.
14 We didn't hear much from bankers about
15 the Report of Examination or the UBPR. Examiners
16 have a lot of suggestions about those areas, but
17 they weren't really viewed as burden issues for
18 community bankers so I think that was where the
19 community bankers were focused on.
20 So those were the themes in a nutshell.
21 And so as we went through them we decided to focus
22 on the ones that cause the most heartache for the

1 community bankers.
2 So at the end of last year we ended up
3 sort of cutting loose the UBPR work. That group
4 already was funded and already did their own work
5 on the UBPR.
6 If you haven't looked at it lately, it's
7 pretty interesting. They have added very useful
8 graphical capabilities to the UBPR, which is
9 hopefully much more helpful to you, and they are not
10 done either. They are continuing to look at ways
11 that they can continue to improve that.
12 And then in March we released -- to deal
13 with that first theme of communication through the
14 FFIEC we released a short press release and advisory
15 to kind of deal with these communication and
16 transparency themes.
17 And the release, we put it in your
18 package, it sort of tells the public about the
19 status of the project and the themes we have heard
20 and basically indicates that the FFIEC principals
21 are really committed to good communication and
22 transparency in the examination process and that we

1 strive to be clear, timely, and transparent in our
2 communications and that we are going to reinforce
3 and reiterate this through internal guidance for
4 examiners.
5 We talk about several broad principles
6 about exam communications, and these are assisting
7 community banks in preparing for the examination,
8 and that's in terms of prior notification about
9 space, staffing, and logistics, and, you know, we
10 would expect examiners to be very clear about all
11 of those things with our bankers.
12 It talks about tailoring the exam
13 request list and scope to the unique risk profile
14 and business model of the institution. That is
15 something that we continue to work on here at the
16 FDIC and continue to focus our examiners on that and
17 are doing work about helping them understand what
18 it means for banks to have different business models
19 and different risk profiles.
20 And sometimes banks have different
21 business objectives, you know, a. A mutual is
22 going to be different than a stock, and helping

1 examiners understand those differences is very
2 important.
3 We talk about, you know, facilitating
4 the secure exchange of information between bankers
5 and examiners as efficiently as we can. We talk
6 about keeping institution management informed of
7 areas under review, providing lots of opportunities
8 to communicate.
9 I think it was in this group somebody
10 said we love weekly meetings and every Friday we get
11 together with the exam team and, you know, we raised
12 that with some of the other bankers and everybody
13 seemed to really like that.
14 I say everybody, but there is one person
15 who didn't want us there at all, but that was an
16 exception.
17 (Laughter.)
18 MS. MILLER: And then, finally,
19 ensuring that the examination results are clearly
20 understood and establishing clear expectations
21 regarding the items that the banks are expected to
22 address.

1 And that's something, even though there
2 weren't a lot of ROE comments, it's something that
3 we have been working on making sure that actionable
4 items are clearly identified in the exam report
5 rather than having you, you know, go sort of hunt
6 and peck through the report. So that is something
7 that we have worked on here at the FDIC.
8 So this statement here -- exam
9 modernization project, it's not, you know, super
10 new and innovative. We didn't intend it to plow a
11 new ground, but we intended it as a reflection of
12 our current policies.
13 And then, sort of, to make sure that the
14 bankers and the examiners understood that we heard
15 your number one complaint about communication and
16 that we are committed to doing a good job about it.
17 So the second theme was sort of the idea
18 about moving more work offsite, and we compared
19 notes on that as well, and we found out that
20 currently we can and we do do some stuff offsite,
21 . Where a bank is heavily a user of imaging we could
22 do loan reviews, and sometimes not offsite, but

1 sometimes with a dedicated model -- dedicated
2 model, dedicated computer with a password at the
3 institution, but we definitely think there is more
4 room to do more work in this area.
5 Loan review is a low-hanging fruit. It
6 takes a lot of time, so about 40 percent of the exam
7 time on average is spent on loan review. So this
8 is where the loan imaging project comes in Chad
9 mentioned. We call it Project FIVE here.
10 But in April we issued a notice to
11 bankers, to servicers, anybody else who was very
12 interested though our financial institution letter
13 process that said we were going to be piloting a
14 project for reviewing standardized loan file images
15 offsite.
16 And then we followed that up with a call
17 in May, and we did have a lot of servicers on the
18 call who were interested in participating in this.
19 So Project FIVE stands for File Image
20 Viewer for Examinations. I think Bob said we have
21 to have acronyms for everything, so we call it FIVE.
22 And then, prior to the release to the

1 public, we did share the project specifications
2 with the other agencies, so the idea is hopefully
3 they'll find it useful as well and we can come up
4 with some sort of a standardized loan file to review
5 offsite, regardless of who the regulator is.
6 So we did that in May, that call, and we
7 began piloting the process. We now have -- We
8 finished our first institution and we've got
9 another one lined up.
10 They are volunteers, it's not required.
11 But we plan on doing a number of different, doing
12 these with a number of different institutions so
13 that we can kind of gather some lessons learned, and
14 the idea is that at the end of this year we'll have
15 what my friends in IT call a virtual symposium where
16 we kind of talk about lessons learned and ways to
17 expand this thing.
18 And I think really if we can get this
19 right and if servicers choose to adopt it, it really
20 has the ability to vastly expand the work that we
21 do offsite and without compromising our efficiency
22 or our effectiveness.

1 So regarding the risk focusing, and this
2 is the thing where people don't believe that we risk
3 focus, we did talk about best practices across the
4 agencies, and we kind of came to the conclusion we
5 all risk focus, we all really make an attempt to do
6 it.
7 We all have different approaches to
8 tailoring our exam procedures and this is largely
9 because of the way we are structured.
10 You know, like the FDIC and the Fed we
11 alternate exams with the state often for well-rated
12 institutions and for states that have an
13 appropriate program, whereas the OCC's they call it
14 following themselves.
15 So their planning and their scoping
16 tends to be a little bit different because of that.
17 So we realized certainly at the FDIC that we could
18 do a better job about documenting exam plans and
19 scopes using available information to help scope.
20 And another important principle for us
21 as managers is that we need to make sure we give
22 examiners enough time to do the scoping properly.

1 So what we heard from you guys is you don't really
2 understand about our risk profile, and we heard from
3 examiners you don't give me enough time to sit there
4 and understand the bank's risk profile and go
5 through this stuff.
6 So we really think that giving them time
7 to tailor the request list, understand the bank is
8 important, that's something that is hopefully
9 within our control.
10 And then just, you know, examiners need
11 to be clear in scoping. They need to explain why
12 certain procedures are being done. You know, this
13 whole thing about, well, I'm this -- yYou look, we
14 heard this a number of times, I am a little bank in
15 the middle of nowhere, and I have had the same ten
16 large loans and you look at the same ten large loans
17 now for like seven years in a row.
18 So we need to explain, and if that's not
19 necessary we need to scope that out, and if it is
20 necessary then we need to explain why we are doing
21 it.
22 And then I would say that, you know,

1 tailoring for risk, it doesn't stop at the end of
2 the exam. We encourage and require actually
3 examiners to communicate in between the
4 examinations.
5 We talked about the surveillance
6 systems and we want to make sure we understand
7 whether things have changed.
8 And then I talked a little bit about on
9 the fourth theme the actions that we have taken on
10 the file transfer system.
11 So we have definitely worked behind the
12 scenes on improving the flow, and we also have been
13 working on some training for examiners and some
14 handbooks for institutions and perhaps a video, you
15 know, . We have that video series on particular
16 issues that are of interest to bank officers and
17 directors, and are working on one on FDIC*connect*.
18 So that's sort of where we are with the
19 project now. I could pause before going into other
20 topics.
21 MEMBER TOLOMER: Yes, Rae-Ann, I think
22 you have made a lot of progress and I can tell you

1 from my own personal experience, I guess it's now
2 a number of months ago, a lot of what you just said
3 actually happened and it was very smooth.
4 MS. MILLER: Good.
5 MEMBER TOLOMER: And the 18 months
6 versus 12 months would be less of an issue because
7 it was less intrusive, but it was more comprehensive
8 because we had a meeting, . We went through the
9 conversation about the bank and what has happened
10 with the bank.
11 Nothing got lost, what we uploaded,
12 people read, you came onsite, you were prepared.
13 You came out to talk to our people when you needed
14 to for clarification, I had a weekly meeting with
15 the examiner in charge, and so it was a very smooth
16 process and we were able to fix things.
17 If there was something wrong, we were
18 able to fix it immediately. One suggestion while
19 you are looking at this is, and nothing specific
20 comes to mind, but let's just say a policy gets
21 criticized for lack of clarity or something, . So
22 we look and say, well, okay, great, you know, you

1 have commented, do you have kind of the blue ribbon
2 or a gold standard policy.
3 Oh, we can't give that to you, we can't
4 comment. No, no, you already have commented, but
5 maybe what the FDIC can do is create a database of
6 say two or three policies or procedures where we
7 might be criticized because, at the end of the day,
8 the CEO and the regulators want the same thing, .
9 They want a strong, profitable, vibrant bank, and
10 compliant.
11 So if you have those -- , wWhen we are
12 asked, oh, I need an accountant or I need a lawyer,
13 we don't give out one, we give out three names and
14 let the people decide who they want to work with.
15 If we were being -- aAnd these are not
16 major criticisms, -- but you have commented and said
17 you should enhance this, well give us the answer to
18 the quiz or show us two or three different options
19 that we could adopt and say, okay, does this work
20 for our business.
21 So it's not just a criticism, it's a
22 criticism, that's fine, I want to hear it, but here

1 are some other options, because we are of like mind,
2 we want the same thing.
3 And so I would ask to figure out is there
4 a way for you to, "you" the FDIC, to show us, hey,
5 here is two or three options that you could utilize
6 that would satisfy what we are looking for.
7 MEMBER DONNELLY: I would like to
8 follow up on that, if I may, and I appreciate the
9 comment, and I go back to data, and Jonathan is over
10 there probably writing notes about we now, but --
11 MS. MILLER: We Millers stick together.
12 MEMBER DONNELLY: But it was early on
13 and you talked about data and you utilized that data
14 and if you are seeing trends, if we see that in
15 advance, and you'd probably give it to us, you said
16 some banker said, well, we gave you that three
17 times, you didn't listen to us.
18 Well, bankers need to listen, too, and
19 if you are sending this stuff out -- but a more
20 focused or in advance laundry list of what I think
21 he was talking about, here are the high points, here
22 are the bullet points that we are seeing in industry

1 be prepared, and we can deliver that information to
2 you more -- because you are seeing it, I mean you
3 are gathering the data anyways.
4 And if you are seeing trends and
5 directions and you want to know in advance what we
6 are doing to tailor the exam down to more of a where
7 are the stress fractures at so we can find them and
8 fix them, if you are seeing it in advance, tell us
9 what you need to look at and where you are seeing
10 the stresses in the area.
11 We have it generally. I would think
12 most banks would have that information to deliver
13 it to you in advance. I hope that makes a little
14 bit of sense.
15 MEMBER TOLOMER: Well, Chris, what we
16 do differently, which I think gets to this
17 information, is we meet every six months with both
18 sets of regulators together.
19 So I go into New York City, I meet with
20 the state and the FDIC office and tell them what's
21 going on, and we do it every six months and so that
22 they always have a sense or an understanding of what

1 is happening with our bank.

2 And when we were setting up for safety

3 and soundness and we had the Q&A, or the discussion

4 on the phone, it was all pretty consistent.

5 So the FDIC came in and they were pretty

6 well prepared to understand what they were looking

7 at, and that might be another way.

8 And I know that both sets of regulators,

9 and, frankly, I like the idea of meeting every six

10 months or so because I get a chance to say, okay,

11 tell me where are the potholes out there, what do

12 I need to know, what should I be avoiding, and so

13 we have a very healthy dialogue to be able to operate

14 the business, you know, the bank, on an ongoing

15 basis.

16 I was just looking at it from a

17 perspective of, you know, if you have a criticism,

18 you see a lot more banks than we do, so if there is

19 a criticism or a need for enhancement, could you be

20 the resource since you see 5,000 banks to help us

21 streamline that rather than to figure it out, put

22 it in, and you come back in 18 months and say, oh,

1 that's not what we were looking for.
2 Hey, just give us the answer to the quiz
3 and give us options.
4 MS. MILLER: I mean, for what it's
5 worth, John, you are describing the very reason why
6 we issue supervisory guidance --
7 MEMBER TOLOMER: Right.
8 MS. MILLER: -- you know, and what we
9 expect and what we see and it's typically
10 principles-based.
11 The only issue about your gold-plated
12 thing that makes me a little bit worried is that we
13 do get criticized if we put something out that is
14 such a bright line, oh, you're going to hold me to
15 that, or that perhaps we would be putting our stamp
16 of approval, FDIC stamp of approval, on a private
17 product. So that's only sense that I have there.
18 MEMBER TOLOMER: Yes. No, I
19 understand that. You know, look, we are adults and
20 so we understand that, and I'm not going to try to
21 use it as a defense of well you gave me this
22 information so, therefore, you can't criticize me,

1 I get that.

2 And we have to use our own candle power
3 to really figure out is this the right thing for us
4 or not. B, but it helps to guide whatever that
5 enhancement suggestion is and, you know, we
6 understand that we make the decision, what we put
7 in is our responsibility, and we can't go back and
8 say, well, you know, you told us.

9 That's -- I don't think that many would.
10 Well, I guess there would be some that would do that,
11 but, okay.

12 MEMBER BAER PAINE: I do think, to
13 John's point, I do think that the opportunity that
14 your examiners do have when they are onsite, and so
15 I am just going to say this, and I have told Doreen
16 and many people this many times, we have great
17 crews.

18 The crews we work with are just
19 wonderful, all our exam crews, whether it's
20 compliance or safety and soundness or CRA.

21 But the opportunity that your examiners
22 have is when they are onsite and they say, for

1 example, in your policy, maybe grab your appraisal
2 policy or your credit guidelines or your IT or
3 whatever it is, we would like to see this, this, and
4 this, let's sit down and look through your policy.
5 This is, I would like to see this topic
6 addressed in this area, I would like to see this
7 topic addressed in this area, or even kind of
8 helping through that, a little hand holding, but if
9 it's being written down as a criticism really help
10 us lay out -- They don't have to put the words in
11 our mouths, but they have to give us the topic that
12 goes in what they would like to see so then we can
13 take off from there. I think that's helpful.
14 The other thing that I think would be
15 helpful is, as you are talking about the data that
16 you use to track, whether it is from the Call Report
17 or UBPR or wherever you are getting that data for
18 the tracking, the bank goes along, green light,
19 green light, green light, yellow light.
20 When it hits that yellow light, that
21 warning signal for you, is that an opportunity for
22 you to reach out to the bank and say, "Hey, you hit

1 that yellow light?" And I don't know if you do that
2 now, but --
3 MS. MILLER: We do.
4 MEMBER BAER PAINE: -- you know, that's
5 something that before we get onsite you should take
6 a look at.
7 MS. MILLER: We do. We have a number of
8 those surveillance systems that trigger a reaction
9 and the first reaction would be a call to the
10 institution.
11 It could be growth, it could be
12 liquidity changes. We've got asset classes that we
13 look at, oil and gas, CRE.
14 MEMBER BAER PAINE: Okay. Thanks.
15 MS. MILLER: Great, thank you.
16 MEMBER DONNELLY: One final question,
17 or just a comment on the value of an examiner coming
18 into the bank. We value that. I hope it doesn't
19 go away.
20 The field people in Kansas City are
21 great and we value them coming in and utilize it as
22 another tool and are we doing things right along

1 with our external auditors or internal auditors and
2 I would just encourage that any way possible, keep
3 as much of that open.
4 It is -- Sometimes I think it's an
5 interference, there's just a lot of people there,
6 but the communications are really important to me
7 and to our shop to hear and a face-to-face
8 conversation of really what's going on. So just a
9 comment.
10 MS. EBERLEY: Yes, it's extremely
11 important to us, too, and we want to just make sure
12 that we are striking the right balance between how
13 many people are we sending, how long are they
14 saying, you know, so just enough to get what we need
15 and to have the good communication, but not too
16 much, and let's do what we can do offsite offsite.
17 MEMBER MENON: But, yes, I got to second
18 that comment about trying to keep that onsite
19 presence going.
20 MS. EBERLEY: Absolutely.
21 MEMBER MENON: But absolutely if there
22 is a way we can reduce that timeframe because we've

1 got a safety and soundness exam coming up, I think
2 it's scheduled for three weeks even though we upload
3 a lot of the information through the FDIC*connect*.
4 I was wondering if there is a timeframe
5 that you might see that reduced down to two weeks,
6 ten days, or something of that sort?
7 And primarily because, you know, when
8 you have 11, 12, 15 people show up, including the
9 state, in our case it's a joint exam, and in a small
10 bank it basically takes a lot of our conference room
11 facilities and whatever else space we have got.
12 Not that we don't appreciate having them
13 onsite, but if we can keep that to a lesser amount
14 that would be helpful.
15 MS. EBERLEY: Okay. Yes, I think
16 that's exactly what we are aiming for.
17 MEMBER MENON: Thank you.
18 MEMBER WILLIAMS: I would make a
19 comment on that same point. Our last exam, again,
20 went incredibly well, the interaction was
21 phenomenal. We did the weekly meetings, not just
22 with me, but with the whole leadership team and the

1 leadership exam team every Friday.
2 It was a phenomenal interaction. That
3 we need to continue to keep going. A lot of
4 feedback. And even to the point where, you know,
5 I don't want to get anybody in trouble, but where,
6 you know, I'd say tell me who has a good plan, he
7 said, "Oh, you might talk to so-and-so, you know,
8 give John a call at West Chester, they've got a
9 pretty good program there."
10 That's pretty helpful for us and then we
11 get to, you know, you're not guiding us but you are
12 giving an example of something you like and we've
13 got a contact. I think that is good.
14 But then also managing the disruption is
15 the tough thing. It's not the leadership
16 interaction, that's phenomenal, it's some of the
17 back and forth and finding and digging and we've
18 sent it to you four times, here it is again, that's
19 a little bit of internal disruption.
20 And I don't know how you manage that.
21 If there is a way to digitally connect the
22 information and have an exception list that comes

1 out once a week or something that we can figure out
2 together, but one-on-one critical managed
3 disruption, and I would add we had a three-week time
4 period as well but they were done in two and they
5 left a week early.
6 CHAIRMAN MCWILLIAMS: Don't tell him
7 that.
8 MS. MILLER: Yes. You know, I mean as
9 the disruption goes I mean it's disruptive for the
10 examiners, too, right. So I mean it's kind of a
11 win-win if we can do a better job in being more
12 efficient offsite and utilize the machines.
13 You know, you don't need to be sitting
14 there flipping paper in a conference room, -- you
15 could flip that somewhere else virtually. So, I
16 mean, I think it has a lot of promise if we can get
17 this right.
18 MEMBER DAKRI: I think from my side the
19 communication has been great during the exams and
20 up to the exit and then there is that black hole,
21 which is the exit, and then waiting for the actual
22 report.

1 So we had, not safety and soundness, but
2 compliance several months back, and they left and
3 everything was fine, and then it was three months
4 and we're like, okay, anybody know what's going on
5 with the report, where it is, and then it just showed
6 up one day. There you go, it was done.
7 But, you know, for us in management
8 we're like is something wrong, did they change
9 something, are they looking at something, what
10 happened in the meantime?
11 So any type of communication between the
12 time they leave the field and the actual report
13 comes out would be beneficial, I think, to us just
14 to say we're still in process, or we're just behind,
15 or whatever it might be.
16 MS. EBERLEY: And I think we try hard to
17 do a good job. We turn around one- and two-rated
18 examinations in less than 30 days is our average,
19 and we believe that is important, as well, to get
20 you your feedback as quickly as possible.
21 MEMBER DAKRI: Yes. I mean to be fair
22 it was compliance, not safety and soundness, but

1 still it's --
2 (Laughter)
3 (Simultaneous speaking)
4 MR. PEARCE: Yes, I just wanted to
5 mention that is actually one of the projects we are
6 undergoing right now to take a look at what happens
7 post onsite in the review timeframes.
8 For the most part, we turn our reports
9 around pretty quickly, but we have identified some
10 situations where it gets elongated and we really
11 want to try to take a look at that.
12 So I am glad you provided that comment
13 because it will help us in continuing our review of
14 this issue.
15 MEMBER DAKRI: Thank you.
16 MEMBER TURNER: Could I just add one
17 thing? You know, I agree with everything that
18 everybody said.
19 I think as, you know, we all have an
20 interest in the process as examined institutions
21 and I think you guys do an awfully good job with that
22 and I think it's a worthwhile process and a helpful

1 process.

2 But we also have an interest in what you

3 are doing as members of the insurance fund. We all

4 have this large, contingent liability that's our

5 membership, you know, our interest in the

6 membership fund and we talked about at breakfast

7 that, you know, that there were some large

8 institutions that failed or close to failed that if

9 the resolution process hadn't worked so well the

10 fund could have been another $150 billion or

11 something underwater and, you know, that would have

12 been all of us kicking in our fair share.

13 I mean, take 1 one percent of your

14 assets, or whatever, and that's about what we would

15 have had to paidpay. So anything, I mean you guys,

16 I view the FDIC as our protection against having to

17 do that.

18 So, you know, as you think about really

19 risk focusing, I hope you'll think about, okay,

20 where really is our risk, and I assume it's with the

21 larger institutions, and I am sure this is a

22 political issue, but being involved, it may not be.

1 You know, the more you can be involved on the front
2 end before a problem develops, that something
3 fails, the better off we are all going to be as
4 members of the insurance fund.
5 MR. DAVIS: So I'll just -- I'm sorry to
6 play timekeeper again --
7 MEMBER TURNER: Okay, sure.
8 MR. DAVIS: -- but we do just have a few
9 minutes left for this panel, so there were a couple
10 other topics.
11 MS. EBERLEY: So how about we switch
12 over to Lisa and talk about BSA, and we'll try to
13 pick up any other items in the supervision section
14 next.
15 MS. ARQUETTE: Thank you, Doreen. I
16 can go through this fairly quickly. In your
17 materials, you do have four slides so I will just
18 kind of zip through them, but I will be here at lunch
19 if you have any follow-up questions.
20 So, just generally as far as the EGRPRA
21 process goes, it doesn't cover the Bank Secrecy Act,
22 -- the technical requirements like the reporting

1 and recordkeeping, . It covers regulations that
2 are issued by federal banking agencies like the
3 FDIC.
4 However, I think at least 40 commenters,
5 maybe every commenter had a little something to say
6 about Bank Secrecy Act compliance.
7 So what we did was package up the
8 comments and provide those comments not only to
9 Treasury but also a bureau that oversees Bank
10 Secrecy Act compliance, that's the Financial Crimes
11 Enforcement Network.
12 But the one connection between the
13 banking agencies and the Bank Secrecy Act is that
14 we all were required to issue regulations to ensure
15 that banks comply with the Bank Secrecy Act.
16 So for us that's 326.8 in the FDIC rules
17 and regs, so we are connected to it because we
18 require a BSA compliance program, but all of the
19 discrete elements in reporting requirements you are
20 going to find those in FinCEN's rules, with the
21 exception of suspicious activity reporting.
22 So real quickly, issues that bankers

1 raised were what about increasing thresholds for
2 currency transaction reports? Those have been in
3 place since 1970. A long time, no adjustment for
4 inflation, and people use cash a little bit
5 differently.
6 What about adjusting the threshold for
7 suspicious activity reports? There are a couple of
8 different thresholds, whether you know the
9 individual that is transacting in your institution,
10 maybe you don't know the individual, it's a wire
11 transfer, or maybe it's an insider-related matter,
12 in which case currently there are no thresholds.
13 So the recommendation was, you know,
14 make it easier, adjust the thresholds. Another
15 consideration that was raised was increase the
16 timeframe within which you come in and examine for
17 BSA compliance.
18 Now we are required to examine an
19 institution pursuant to Section 8 of the FDI Act
20 every time we conduct a safety and soundness
21 examination.
22 So the benefit of extending the cycle

1 for well-managed institutions, well-rated,
2 well-managed institutions, is that you are going to
3 see us less frequently in terms of examining for BSA
4 compliance.
5 Those go hand-in-hand, provided the
6 compliance program is running smoothly, and we are
7 fairly certain that most banks have compliance
8 programs that are running smoothly, because it is
9 infrequent that we take enforcement actions, just
10 to put that out there.
11 A couple of additional items that were
12 raised were provide more clarity related to
13 customer due diligence. FinCEN issued a rule in
14 May of 2016. Since then they have issued two sets
15 of frequently asked questions.
16 The responses have been included.
17 Since then the rule has become effective in May of
18 2018. Since then the banking agencies, the FDIC
19 included, we have issued our examination overview
20 and procedures and made those public to the
21 industry.
22 So since then, since the EGRPRA

1 comments, there has been an awful lot of guidance
2 and procedures issued related to the implementation
3 of those rules.
4 And, finally, the issue that was raised
5 was cost. Bank Secrecy Act compliance is
6 expensive, . It takes a lot of resources. What
7 can you do about that, and can you make sure that
8 there is consistency among your examiners?
9 So those are within our purview, and we
10 can address those types of things, and we are
11 working really hard to address them. That was one
12 slide. Let me flip through the next three real
13 quickly.
14 So what we did was gather up the comments
15 and provide them to FinCEN and to Treasury. FinCEN
16 is part of Treasury. They were very quick to
17 respond.
18 We do work with them regularly and they
19 said that they were considering thresholds, they
20 met with law enforcement, and these are issues that
21 are addressed at every Bank Secrecy Act advisory
22 group meeting.

1 That is a public-private partnership
2 between government agencies, banks, other
3 financial institutions that are covered by the BSA
4 like securities brokers, dealers, precious metals,
5 precious gem dealers, money service businesses.
6 Anyhow, there is a semi-annual meeting
7 where a lot of these issues are discussed and there
8 are many subgroups. We have lots of subgroups
9 within the beltway, but they have been fairly
10 effective in dealing with issues like thresholds.
11 So FinCEN committed to making sure that
12 these issues were raised to the BSAAG and these
13 issues are discussed during FFIEC Bank Secrecy Act
14 Anti-Money Laundering Working Group meetings. One
15 is being held right now as we speak. The FDIC
16 chairs that committee.
17 So there are many venues where we
18 discuss these issues, but we always discuss them
19 with information with feedback from law enforcement
20 so that there aren't steps that are taken that would
21 undermine the benefit of this information.
22 So FinCEN was very responsive and

1 continues to be responsive. Now, quickly, what can
2 we do in terms of supervision? Examination
3 frequency for the most part has been addressed for
4 well-managed, well-rated institutions.
5 Customer due diligence and beneficial
6 ownership information, -- our procedures have been
7 issued. We plan to host a call with the other
8 banking agencies open to the industry to not only
9 review the procedures and overviews but also to take
10 questions very specific to this issue. We plan to
11 do that during the third quarter of this year.
12 And, finally, in terms of cost and
13 burden we are very cognizant that the cost has
14 increased. The Bank Secrecy Act has been in place
15 for nearly 50 years and resources dedicated to this
16 space have increased.
17 But the value of the information has
18 also increased to law enforcement, so really there
19 is an obligation to make sure that that information
20 gets out there, that banks are aware of how very
21 important your contributions are, the reporting
22 that you do.

1 But, separately, and as a segue from
2 what Rae-Ann was talking about for risk focusing,
3 we really are keenly focused on making sure that we
4 have the right resources at your institutions at the
5 right time based on the complexity of your
6 institution.
7 Not every bank has the same risk
8 profile, the same products, services, customers,
9 and entities, . You don't all operate in the same
10 geographies, and we are aware of that.
11 So we are working pretty hard to make
12 sure that we are addressing that, and that, if
13 possible, we can address procedures that might be
14 tailored differently to lower-risk institutions.
15 So we are working with the other banking
16 agencies, with Treasury, and with the Financial
17 Crimes Enforcement Network. All right, it's
18 11:15.
19 CHAIRMAN MCWILLIAMS: Good job, Lisa,
20 keeping us on schedule.
21 MR. DAVIS: Yes, I mean I think since we
22 have some of the same participants in the next panel

1 if there is a question or two I think we could
2 certainly take time for that.
3 MEMBER SCULLY: We're going to talk in
4 more detail about beneficial ownership?
5 MS. ARQUETTE: We are. We are.
6 MEMBER SCULLY: All right.
7 MS. ARQUETTE: I would point out that
8 that is FinCEN's rule, but I am happy to talk about
9 it, and I will.
10 MR. DAVIS: Okay. So if I could ask Bob
11 to come back up and join us for the --
12 MS. EBERLEY: I'm just going to stay if
13 that's okay.
14 MR. DAVIS: Okay. We are going to do an
15 update on several supervision issues with this
16 panel and we have, again, the same panel, adding Bob
17 as well, and Rae-Ann is going to talk about guidance
18 issued by the FDIC and other federal financial
19 institution regulators about supervisory practices
20 to be followed when assessing banks impacted by
21 major disasters.
22 Bob is going to talk about the

1 accounting and reporting implications of the new
2 tax law. Bob is also going to review an example
3 relating to implementation of the current expected
4 credit losses methodology.
5 And, finally, Lisa is going to provide
6 an update on customer due diligence and beneficial
7 ownership requirements.
8 MS. MILLER: Okay. All right, so real,
9 real, fast just to close out the last panel I was
10 going to talk a little bit about, and be very quick
11 about we also committed to doing a review,
12 interagency review, of our guidance documents, and
13 so we are embarking on that with the other agencies
14 starting there, you know, things that are short of
15 regulations but are supervisory guidance
16 documents. So we have pretty much just started
17 that.
18 And then I just want to touch on, we
19 talked about it a little bit this morning, but also
20 as a follow-up on EGRPRA, we very recently raised
21 one of the thresholds in our appraisal regulations.
22 And just to refresh, you know, Title

1 11XI of FIRREA required the agencies and NCUA to
2 adopt appraisal regulations, and that law came out
3 in 1989.
4 We issued regulations first in 1990,
5 1992, and then did a big overhaul in 1994, but
6 haven't looked at them since. The law allows us to
7 set exemptions in our regulations, and those
8 exemptions apply to institutions or to transactions
9 where if the exemption applies you don't need to
10 have a licensed or certified appraiser perform an
11 appraisal on those transactions.
12 So we got a lot of comments in EGRPRA.
13 Y, you haven't looked at those thresholds since
14 1994, you know, it's 24 years on now, so we did look
15 at those.
16 We put out a proposal in 2017 on raising
17 the threshold for commercial real estate. We
18 actually defined what we meant by commercial real
19 estate and proposed a threshold raise of $400,000,
20 from $250,000 to $400,000.
21 So the comment period closed in
22 September 2017. We got about 200 comments, and you

1 can imagine where they were divided between bankers
2 and appraisers.
3 But, basically, the final rule creates
4 a new definition of and separate category for the
5 purposes of the rule for commercial real estate
6 transactions.
7 It raises the threshold for requiring an
8 appraisal on those from $250,000 to $500,000. That
9 nearly doubles the percentage of the number of
10 transactions that would be exempted.
11 So it goes up from about 16 to about 32
12 percent of the number of transactions that would be
13 exempted, but it only affects a small amount of the
14 dollar amount.
15 So only about a 50 basis points lift was
16 achieved with that. So 1.3 percent of the dollar
17 volume of transactions would be affected. So these
18 kinds of numbers enabled us to say, you know,
19 raising the threshold to $500,000 doesn't really
20 create a huge safety and soundness issue because
21 really from a dollar perspective not that much has
22 changed.

1 From a burden perspective, some of those
2 transactions that Chris was describing, it has a big
3 impact from going from $250,000 to $500,000,
4 especially for smaller institutions.
5 And just a reminder that even for those
6 exempted transactions, they would still be subject
7 to having an evaluation done, but the evaluation
8 doesn't need to be by a licensed or certified
9 appraiser.
10 So I did speed talking on appraisals.
11 Does anybody have any further comments?
12 (No audible response)
13 MS. MILLER: No. Should I move on to --
14 Okay, so I will move on to a piece of, we call it
15 examiner guidance, but just sort of instructions
16 for examiners that we issued at the end of last year.
17 So it's the FDIC, the Fed, the OCC, and
18 the NCUA, and we were consulting with the CSBS,
19 Conference of State Banking Supervisors. We
20 issued examiner instructions to talk about the
21 supervisory practices that would be followed in
22 assessing financial condition of insured

1 institutions affected by a disaster.
2 And the disaster would be something that
3 resulted in an order from the President that
4 declared the area a major disaster, and there is
5 different declarations, and a significant
6 declaration is declaring a major disaster with
7 individual assistance, and that's typically when
8 these instructions kick in.
9 So, you know, we talk about -- we
10 recognize that extensive damage, and you remember
11 last year we had a terrible hurricane season, we had
12 the fires in California, we understand that it
13 affects the business activities, it affects the
14 borrower's activities, and could do so for an
15 extended period of time.
16 So we talk about in the instructions
17 that the examiners are going to work with
18 institutions affected to determine their needs,
19 reschedule any examinations as necessary, consider
20 extensions of filings for Call Reports, and address
21 capital declines due to temporary deposit growth,
22 -- sometimes you get a surge of deposits in these

1 situations.
2 And we talk about in the instructions
3 supervisory practices for these types of
4 institutions, and they could be located in a
5 disaster area or have a lot of loans or investments
6 that are in the disaster area, and we basically tell
7 examiners you need to consider how management at the
8 affected institution is dealing with the situation.
9 How have they conducted an initial
10 assessment? How are they dealing with information
11 as it becomes available? How are they working with
12 their borrowers as the recovery efforts proceed?
13 We talk about, you know, examiners need
14 to continue to assign component and composite
15 ratings in accordance with the CAMELS rating
16 system, but that they need to also consider the
17 extent to which weaknesses are caused by external
18 factors and not necessarily the management of the
19 institution.
20 So when we are talking about CAMELS you
21 could have a financial condition issue but
22 management is doing everything they can to work it

1 out, and we would consider that in the supervisory
2 response, you know, in enforcement actions and all
3 those kinds of decisions.
4 So that's a good description of the
5 instructions. Any questions?
6 (No audible response)
7 MS. EBERLEY: Can we move on to Bob?
8 MR. STORCH: Okay, thank you. Good
9 morning again. The first thing I was asked to talk
10 about was guidance the agencies issued on
11 accounting and reporting implications, -- the new
12 tax law.
13 I'm sure it's not a surprise to everyone
14 that there was a new tax law. Timing perhaps wasn't
15 that helpful because it was enacted nine days before
16 year-end. And under generally accepted accounting
17 principles which by law, the principles governing
18 the Call Rreport have to be uniform and consistent
19 with that.
20 Whenever there's a change in tax laws
21 and rates, the accounting standards indicate that
22 the impact of those changes have to be reflected in

1 the period that the law's enacted, which is when the
2 President signs the law.
3 So nine days before year-end, there's a
4 change in the tax law. S, so lots of institutions
5 were scrambling to determine what the consequences
6 would be for their year-end reporting purposes,
7 whether it was Call Reports or GAAP financial
8 statements.
9 One of the key elements of the change,
10 particularly for community institutions, assuming
11 you're not sub-chapterSubchapter S, you've got a
12 little bit of a leeway in that case.
13 But if you're Subchaptersub-chapter C
14 and pay corporate income taxes, the deferred tax
15 assets and liabilities on your balance sheet had to
16 be re-measured based on what the tax rates would be
17 when the underlying temporary differences or net
18 operating loss carry forwards would actually flow
19 through and show up in your tax returns in future
20 years.
21 So, basically, moving from a general 35
22 percent federal tax rate to a 21 percent tax rate,

1 which has consequences if you, like most
2 institutions, had net deferred tax assets. You're
3 reducing those assets because the benefit of the
4 temporary differences in future years will only be
5 realized at 21 percent instead of 35 percent.
6 You reduce an asset, the offsetting
7 entry is to income tax expense, which lowers your
8 net income for the period, has an effect on
9 regulatory capital, and so forth.
10 Presumably the lower tax rates would
11 benefit you going forward and help offset the
12 negative effect at year end, reflecting in most
13 institutions' cases that reduction in deferred tax
14 assets and an increase in income tax expense on a
15 reduction, therefore, in retained earnings and
16 common equity tier one capital.
17 So that was one of the elements that the
18 agencies wanted to ensure institutions were aware
19 of. And their issuance on January 18th, and it came
20 out from the FDIC in a financial institution letter
21 to our institutions.
22 The other agencies had their own cover

1 documents but there was an interagency statement.
2 And since it touched on accounting, the agencies'
3 typical practice is to share drafts of these types
4 of accounting guidance documents with the FASB and
5 SEC staffs to make sure that we're not stepping
6 outside the bounds of what's acceptable under GAAP
7 since, again, we're supposed to be reporting
8 requirements consistent with GAAP.
9 So the expectation was at least for sort
10 of the fairly simple process of re-measuring
11 deferred tax assets and liabilities, that would be
12 reflected in the year-end 2017 Call Reports.
13 But one of the unusual consequences of
14 having to do that, if you have available-for-sale
15 debt securities, and again you're paying federal
16 corporate income taxes, the amount that you reflect
17 in your equity capital section of the balance sheet
18 for the unrealized gains and losses is net of tax
19 effect.
20 It had been measured originally when
21 those gains and losses occurred, presumably at a 35
22 percent rate, but the tax rates were reduced to 21

1 percent.

2 And the way the accounting standards

3 work, the change in the measurement of deferred tax

4 assets and liabilities goes to the income

5 statement, even though the tax effect for the

6 unrealized gains and losses on available-for=sale

7 debt securities didn't go through the income

8 statement, it went through what's called other

9 comprehensive income, an overall statement of

10 comprehensive income but separate from net income.

11 So what you ended up with was a disparity

12 between what the deferred tax assets or liabilities

13 were associated with the deferred, with the

14 unrealized gains and losses on available-for-sale

15 debt securities and any other types of transactions

16 that affect other comprehensive income and the AOCI

17 accounting capital.

18 But the available-for-sale securities

19 is the most common source for community

20 institutions. So if you had had say $100,000

21 unrealized gain or loss and the tax effect would

22 have been 35 percent, you adjusted the deferred tax

1 asset from 35,000, or the deferred tax liability
2 from 35,000 down to 21,000, but the net unrealized
3 gains and capital stayed at the net of 100,000
4 reduced by 35,000.
5 And that's the accounting terminology
6 is that's a stranded tax effect. There's a
7 disconnect between the balance sheet deferred tax
8 assets and liabilities and what's in AOCI. So the
9 FASB was made aware of this disparity and
10 particularly for banking organizations and
11 regulatory capital, consequences that some of this
12 may have.
13 And they issued a standard ultimately in
14 February, but they agreed to propose it in January.
15 So our guidance essentially allowed institutions to
16 early adopt the standard for year-end 2017
17 reporting purposes if they chose to, it wasn't a
18 requirement, to eliminate the disparity caused by
19 these stranded tax effects. So that's addressed
20 and is an example in the interagency statement.
21 And then the final element we talk
22 about, it ties back to the regulatory capital rules.

1 I'm sure you're aware there's limits on certain
2 categories of deferred tax assets or net deferred
3 tax assets, any that are resulting from net
4 operating loss carry forwards or fully deducted
5 those that are dependent on, or that could be
6 realized through carry-backs are not subject to
7 limit.
8 Those that are subject to future taxable
9 income for realization, if they exceed certain
10 thresholds, are deducted, those excess amounts are
11 deducted from common equity tier one capital.
12 One of the consequences of the new law
13 is it eliminates, for 2018 and beyond tax years,
14 carry-back potential. So essentially, all
15 deferred tax assets now become dependent on future
16 taxable income. And even though the tax rates are
17 lower, the entirety of those deferred tax assets net
18 of liabilities under the capital rule are subject
19 to these limitations.
20 So that's one element of the capital
21 rules. There is an effort underway through
22 rulemaking, and unfortunately Ryan's not with us

1 anymore, he could answer questions on it perhaps,
2 but to do some simplifications to the capital rules
3 and deferred tax assets was one area that was
4 addressed in the proposal issued last year.
5 There's a minor silver lining, if you
6 will. To the extent your bank actually pays
7 current taxes in during a particular year and if you
8 assume that all your deferred tax, your temporary
9 difference is fully reversed and you have a tax loss
10 hypothetically, you can offset it against and
11 recover current taxes paid.
12 To that extent, those would be viewed
13 for regulatory capital purposes as available to be
14 recovered through carry-backs. So some small
15 portion in some banks of their deferred tax assets
16 may not be subject to these potential threshold
17 deductions.
18 So those are some of the key points from
19 the statement that was issued in January. I can
20 stop there and see if you have any follow-up
21 questions on that particular topic. Taxes is never
22 anyone's focus on these. I know as examiners,

1 everyone wanted to avoid having to do the tax part
2 of the income statements, or review it.
3 So let me turn to the second topic I was
4 asked to talk about. In February, the banking
5 agencies, well the Fed and the FDIC along with the
6 Conference of State Bank Supervisors, and we had
7 participation as well from the SEC and the Financial
8 Accounting Standards Board, conducted a webinar
9 that focused on trying to assist community
10 institutions and get a start on understanding some
11 of the more simple loss rate methods that could be
12 used at a community institution as a starting point
13 for estimating historical loss experienced under
14 the new current expected credit losses methodology.
15 So that was at the end of February.
16 There's an FDIC Financial Institution Lletter that
17 was issued in early February. It includes a link
18 to a recording of this webinar. There's a
19 transcript, there's some presentation slides. I
20 believe you have the slides in your materials.
21 So it's available to listen to as many
22 times as you would like your staff to listen to it,

1 or not at all, at your pleasure.
2 One of the key points, I know I've talked
3 about this before, is the agencies and the guidance
4 we've issued so far, there was a joint statement
5 shortly after the statement was issued by the FASB
6 in 2016 and we've issued two sets so far of
7 frequently asked questions the most recent of which
8 was last September.
9 We've tried to emphasize that,
10 particularly for community institutions, there's
11 no requirement to go out and acquire costly and
12 complex models.
13 We think most community institutions
14 can use simpler approaches that build on approaches
15 you're using today, but there would still be the
16 need to change inputs because we're moving from the
17 incurred loss methodology that's not very forward
18 looking at all to the CECL methodology, the Current
19 Expected Credit Losses methodology, that does take
20 forecast the future economic conditions and other
21 consideration of other future events to come up with
22 an estimate of expected credit losses, not incurred

1 credit losses.

2 By the same token, we know a lot of
3 institutions are being approached by consultants
4 and third-party service providers. There's no
5 requirement the agencies are imposing that those
6 types of services be used. That's a business
7 decision for the individual institution, and I
8 think I've tried to emphasize that at past meetings.

9 The standard itself, very principles-
10 based. It provides a lot of flexibility. Methods
11 that are used today can be used going forward, and
12 I say that with a little trepidation because some
13 people have interpreted that to mean they don't need
14 to do anything at all.

15 The approaches in your model, your
16 methods, can be used, but at least a couple of key
17 inputs would need to be changed going from the
18 typical annualized loss rate to an estimate of
19 historical lifetime loss experience and then
20 building in the economic forecasts, because today
21 you can really only consider past events and current
22 conditions. Now we layer on top of that forecasts

1 that would affect the collectability of loans in
2 future periods.
3 So that takes me to the webinar we had
4 at the end of February. There were three methods
5 that were described and examples provided there.
6 And again, you have the slides.
7 One was called the snapshot or open pool
8 method, there's a remaining life method, and then
9 there's one that FASB also has an example of in their
10 standard, the vintage method. But I thought I
11 would just spend a few minutes going over some high
12 points of the snapshot or open pool method.
13 That, if you're looking at your
14 materials, and I'm not trying to be a teacher
15 telling you you have to, but it starts on Slide 14.
16 And when you go to Slide 15, what we're really
17 talking about with this snapshot method is that
18 we're looking at your loan portfolio or segment,
19 particular segment that you're using.
20 And you can use the same sort of
21 segments, if it makes sense, that you use today for
22 the incurred loss methodology for pools of loans for

1 pools of loans going forward. You can refine them
2 or adjust them as you see fit, but if they make sense
3 today under incurred, again our guidance indicates
4 that they can be used under the CECL methodology.
5 So we're taking, trying to develop an
6 estimate of historical lifetime loss experience and
7 we take a snapshot of all the loans in a particular
8 segment of the loan portfolio as of a specific date
9 and we just, to jump ahead quickly, Slide 18 which
10 kinds of summarizes the example.
11 The bank, at the end of 2015, for a group
12 of loans that are basically five-year type loans,
13 and one way to pool loans is saying maturity but
14 again that's not a requirement.
15 There's a lot of flexibility for how
16 loans are pooled and segmented, and that would be
17 a factor from a qualitative standpoint when you look
18 at that particular pool and how you come up with your
19 overall CECL estimate.
20 But again, the focus of this webinar was
21 on the starting point of historical loss
22 calculation. So we take a snapshot of all the loans

1 in that segment as of a particular date and look at
2 what happens to them until the last loan in that
3 segment or pool actually is paid off or charged off
4 and look at each year, what were the actual charge
5 offs on those loans that existed as of that snapshot
6 date even though the overall portfolio is changing
7 over time.
8 So we're trying to estimate the total
9 charge- offs associated with that particular
10 portfolio that existed at a point in time, we divide
11 that by that starting point number, the portfolio
12 balance or segment balance at that starting point,
13 and that would give us, because we're accumulating
14 the several years' losses, in this example it's on
15 Slide 18, it's five years' worth of charge- offs on
16 that pool that existed at the end of 2015.
17 So by the end of 2020, you're $88,000 in
18 accumulated losses compared to the amortized cost
19 starting point of a little less than $10 million.
20 So the loss rate lifetime was a little less than one
21 percent.
22 The webinar didn't get into the issue of

1 how you adjust for qualitative factors. I know we
2 had a number of requests to have follow-up webinars
3 or additional guidance on that. But this webinar
4 didn't do that.
5 So just like with the incurred loss
6 methodology, you've got a loss rate starting point.
7 The new method, you look at historical lifetime as
8 opposed to annualized and we adjust it to the extent
9 necessary for qualitative factors.
10 What do we see going forward that will
11 cause the losses that existed in that historical
12 lifetime loss period to be different because of
13 different economic forecasts, and so forth.? Or
14 you try to come up with the historical loss period
15 that perhaps best represents what you think will
16 happen in the future, and there the qualitative
17 adjustments may not need to be as significant. But
18 again, qualitative adjustments, hopefully that
19 will be a topic for another webinar that the
20 agencies can present.
21 So just like with incurred losses, once
22 you've got your adjusted loss rate, here's an

1 adjusted lifetime loss rate, we apply that to the
2 then existing pool balance in our balance sheet data
3 to come up with our estimate.
4 And I emphasize that it's simply an
5 accounting estimate, . It's not, you know, a hard
6 and fast forecast. This is actually the amount of
7 charge- offs we're going to have. I think no one
8 will ever get the exact number of charge- offs
9 because that's why it's an estimate, for this
10 particular segment.
11 So that at a very high and fast level was
12 the idea behind this snapshot or open pool method.
13 We have talked to a number of accounting firms that
14 work with community institutions, and they've
15 indicated that they view this as an acceptable
16 approach, assuming it's applied properly and
17 supported and documented.
18 But it is an acceptable approach that
19 can be used, along with the other two methods that
20 were described in the slides that you have.
21 So that's what I wanted to cover on that.
22 And I will mention that we are having another

1 webinar. And, in fact, this one the OCC will be
2 joining the Fed and the FDIC and the states, the FASB
3 and the SEC will again be participating.
4 And we've gotten, as you can imagine,
5 and you probably have questions yourself, we've
6 gotten a number of questions that we didn't get to
7 on the February webinar. The OCC's had some
8 webinars and they have gotten questions, and we've
9 gotten questions from our email boxes, and so forth.
10 We had questions raised by examiners.
11 So we're going to devote an hour and a
12 half or so on July 30th to go through a number of
13 questions that we've received over time about
14 various aspects of CECL. Bankers can submit
15 additional questions in advance, and even during
16 the webinar.
17 We'll just see if we get overwhelmed
18 again with questions and can't cover them all. But
19 those topics are grist for the next set of
20 frequently asked questions that are already being
21 worked on to supplement what's already out there.
22 So with that, hopefully, I didn't drown

1 you with too much details. But we can turn it back
2 to you for discussion or questions.
3 MEMBER HANRAHAN: I'll make a comment
4 if I may.
5 MR. STORCH: Sure.
6 MEMBER HANRAHAN: Actually, two
7 comments. First off, thank you for reiterating
8 that you don't necessarily have to use a vendor for
9 this stuff. I've got plenty of vendors trying to
10 scare me and trick me into buying things. So that
11 comment is meaningful.
12 Fortunately, I've got a credit
13 department manager who's a cracker jack, and he
14 tells me that your February webinar, pardon me, --
15 “Ask the Regulator” webinar, was really good and
16 he's now running vintage analyses.
17 And we're not there yet, but I have a
18 sense that we're going to get there by 2020. So
19 thank you for conducting those.
20 MR. STORCH: Thank you for the
21 comments, and from what I understand, the webinar
22 was very well attended. There were about 8,000

1 lines in use. So there's only 5,000 some banks, so
2 either there were multiple bankers or there's a lot
3 of interest outside the banking industry itself.
4 (Off microphone comments.)
5 MR. STORCH: It's interesting, though.
6 I know in talking to one community banker who's been
7 approached as you have by different vendors, he's
8 inviting them to come in and hear what they have to
9 say to see what nuggets he can take from those
10 conversations and build into their own internal
11 methods that they're developing and trying to avoid
12 actually paying the cost of whatever those types of
13 service providers or vendors or consultants are
14 charging.
15 So there may be a benefit to hearing what
16 they have to say, even if you're skeptical about
17 even going in that direction.
18 MEMBER DAKRI: If I may, I think a year
19 ago we were talking about CECL here and the
20 expectation from the regulators were that we would
21 see an increase in allowances and whatnot.
22 Is that still the case right now? We've

1 gone through our process, just as you have, and I'm
2 not seeing much of a difference overall. We're
3 doing a vintage analysis and the vintage gives me
4 almost a big zero in which I have to then rely on
5 my qualitative factors to get to a number that's
6 meaningful at all.
7 So I personally am not going to see much
8 of a change, I don't believe, but I'm wondering what
9 the thought process is now from the regulatory side
10 as far as, you know, a year later now, what do we
11 think is going to happen.?
12 MR. STORCH: I can start and anyone
13 wants to add to it they can. I mean, from what we're
14 hearing from bankers, it's a similar sort of
15 reaction. The economy seems to be doing pretty
16 well right now.
17 A lot of people are calling it benign so
18 that some of the concerns that maybe existed as the
19 standard was being developed in 2012 and 2013 are
20 no longer present.
21 I mean, the agencies have been trying to
22 avoid any suggestion that there's benchmarks or

1 standardized amounts of increases that we expect to
2 see because it's going to be very institution
3 specific, it's going to depend on the economic
4 forecasts in 2020 or 2021, whenever it is that the
5 effective date applies to your organization.
6 It depends on your portfolio mix. As
7 we've learned more about it ourselves, the shorter
8 the lives of the loans, the expected lifetime losses
9 tend to be less than say with longer- lived loans
10 just because there's more time that a loan could
11 encounter some difficulties.
12 So I think there's only been one bank
13 that I've heard that in their SEC filings has
14 suggested what the level of increase would be and
15 that was about ten percent. Whether that pans out
16 to be what happens in fact kind of depends on what
17 will happen in the future.
18 The international accounting standard
19 on expected credit losses, it's not the same as what
20 the FASB adopted. But the European banks and the
21 Canadian banks and so forth had to adopt it either
22 late 2017 or beginning of 2018, depending on their

1 fiscal years.
2 And they, in many cases, are only seeing
3 five to fifteen percent increase in their provision
4 levels, although they didn't quite, maybe Canada
5 did, but from what I've heard, but the Europeans in
6 particular, even though they had an incurred loss
7 model, they didn't apply it anywhere, with anywhere
8 as much rigor as I think we have seen banks in the
9 US U.S. apply it.
10 So at this point, we're hoping it's not
11 a significant shock. But the agencies did propose,
12 and I think the formal proposal was published in
13 May, that there is, would be a transition option for
14 regulatory capital purposes.
15 So to the extent that there is a
16 significant decrease from the initial adoption in
17 your common equity tier one capital that you could
18 spread for capital purposes, not for accounting
19 purposes, that reduction over three years so that
20 some of the adverse effects on the regulatory
21 capital ratios may not be as dramatic as they
22 otherwise would be.

1 So there's that that's out there. It
2 hasn't been finalized yet. I'm not sure what the
3 timing is but, hopefully, that's something that
4 some banks will consider using as well to mitigate
5 whatever effect, even if it's small, on capital
6 because the proposal is to spread it over three
7 years.
8 Maybe the number is small at initial
9 adoption, but if there's deterioration in the
10 forecast, say a year and a half into the three years,
11 it may be beneficial to have a small add back at that
12 point to your regulatory capital to offset whatever
13 increase you might need to make in the allowance
14 levels because of worsening economic forecasts
15 during that three-year period.
16 At least that's my editorial comment
17 about the benefit of that potential transition
18 rule.
19 MEMBER DONNELLY: Bob, the level of
20 support, and you said support documentation, I know
21 that's going to be relative to each institution what
22 they have. But doesn't the core provider, the data

1 that you can keep over time and how you match it up
2 to get the vintage model, because I was one that went
3 and got a vendor to get it because I can't manage
4 the data from a core provider.
5 So my expectation was the field guys
6 came in, the examiners came in, they would want to
7 see my supporting documentation. What do I have to
8 do? Do you have an expectation set yet? What are
9 the field guys going to be looking for when this
10 kicks in?
11 We got a couple years to go on this, but
12 what are they going to be looking at for supporting
13 documentation? I mean, I can pull out 500
14 spreadsheets on Excel and say here"Here," but I
15 don't think that's what they're going to be wanting.
16 They're going to be wanting to see more
17 clarity, more not simplistic, more efficient
18 reporting. Do you have an idea yet of what you're
19 going to be expecting to see?
20 MR. STORCH: That's one area I think
21 that we're going to need to provide clear guidance
22 to our examiners so they don't sort of overstep

1 their expectations because they should be tailored
2 to the size and complexity of the institution and
3 its portfolio.
4 I mean, that's our general rule
5 throughout all policies. We have existing policy
6 guidance for the incurred loss model about
7 documentation and so forth, and I would think those
8 types of principles that apply today would continue
9 to apply under the CECL methodology.
10 So you're going to have the raw data that
11 feeds into some more aggregated data, and then it
12 will ultimately be summarized up as it goes through
13 your management to the board of directors for their
14 review.
15 So I think that summarization of the
16 data and at least understanding what the source,
17 underlying source data is, I don't, I wouldn't
18 expect examiners to spend time, you know, tracing
19 all the years' worth of individual loan data.
20 They're going to look to the process
21 that they're following or your vendor's following
22 for the documentation and support. And we can

1 clearly get some good guidance, and I think that's
2 one of the questions that's on the table for that
3 July 30th webinar is some more guidance about
4 documentation.
5 MEMBER DONNELLY: I think your comment
6 about you don't expect the examiner to, I mean,
7 that's a really important piece to get out because
8 I've seen them track the data, at least the way I
9 interpret it and I've sat through more CECL seminars
10 than anything I've ever done in 36 years of banking.
11 So you know, from my perspective, the
12 net effect could, doesn't mean it will, it could be
13 significant. And we better be in front of that.
14 So I think your comment is what is my concern is what
15 will the field examiners be looking for in
16 documentation, small shop versus somebody who can
17 throw a couple of accounting people at it is
18 different.
19 MR. STORCH: Yes, very different.
20 MEMBER HANRAHAN: Chris, my hunch is
21 our auditors are going to be giving us a harder time
22 about methodology than the regulators. So I'm glad

1 you got FASB involved in these calls.
2 MEMBER TURNER: We've also used a
3 consultant, Bob. And one of the things they've
4 told us is that as you collect this loss data on
5 pools or cohorts, they really want to see the loss
6 data go back across credit cycles. Do you agree
7 with that?
8 I mean, they don't want, like, if you're
9 collecting loss data on a particular category of
10 loans, they're saying we don't want you to just
11 collect it during a very benign period.
12 We want you to collect it across the
13 credit cycle so we can really get a full picture of
14 how that cohort's going to perform. Is that how you
15 see it as well?
16 MR. STORCH: I think if you're just
17 talking theory and there's no cost for information,
18 that would be the answer.
19 MEMBER TURNER: Right.
20 MR. STORCH: But let's be realistic.
21 You're only going to have data, I mean, if you start
22 collecting data now, I don't think people can hear

1 me. If you start collecting data now, or you
2 started maybe a couple years ago when we put our
3 first joint statement out, you from some loan
4 portfolios you may have the full lifetime. For
5 others you may not.
6 And what we've indicated is you may need
7 to use proxy data to fill in gaps. There may need
8 to be qualitative adjustments to compensate for the
9 lack of complete data. And we're all learning
10 about this as we go forward.
11 Say ten years from now you'll have a
12 pretty good set of data. But to expect every
13 community bank in particular to have loss data and
14 all the other relevant data going back --
15 MEMBER TURNER: Fifteen years, yes.
16 MR. STORCH: -- over a whole credit
17 cycle is not really realistic. There is an undue
18 cost and burden provision within the standard
19 itself, and in the set of frequently asked questions
20 that were added last September, I think one of the
21 first questions talked about data and is there an
22 expectation that community banks would go back and

1 reconstruct data that no longer was readily
2 available.
3 And the short answer was no”No, we're
4 not.” So we’re trying to be realistic, and this is
5 going to be an evolutionary process that the first
6 estimate we want a good faith estimate as best you
7 can do, and document how you got it.
8 And over time, everyone's going to learn
9 and get better at it, just as it's happened with the
10 incurred loss model which we've had for 40 years.
11 Everybody's still making little tinkering
12 improvements over time.
13 MEMBER TURNER: We're a public company.
14 Is it your impression that the SEC is taking that
15 kind of a moderate approach, or are they going to
16 say hey”Hey, the rule's the rule,” and you're
17 expected to, you know, they expect their reports to
18 be in accordance with GAAP. And if it's hard on
19 you, it's going to be hard on you.
20 MR. STORCH: That's probably a good
21 question if you --
22 MEMBER TURNER: For them?

1 MR. STORCH: -- or your staff listen to
2 the webinar at the end of July to specifically
3 direct to the SEC.
4 MEMBER TURNER: Are they going to be on
5 there?
6 MR. STORCH: They will be on there, yes.
7 MEMBER TURNER: Okay.
8 MR. STORCH: They have policy guidance
9 that's comparable to the interagency policy
10 standard on documentation and methodologies that
11 dates back to 2001. I think it's called SAB-102 and
12 it has very similar language and it sets out their
13 expectations for governance and controls and
14 documentation just like our 2001 policy statement
15 does.
16 And they would expect similar
17 documentation in support, but I would imagine they
18 would have a realistic view of what's possible for
19 a smaller community bank that's a public
20 institution.
21 And you can also be talking to your
22 auditors who may have had interactions with the SEC

1 in terms of expectations as well.
2 MS. EBERLEY: All right, thank you.
3 Can we shift over to Lisa, picking back up with BSA?
4 MS. ARQUETTE: Okay. Thank you, Bob.
5 Thank you, Doreen. The topic that I would like to
6 cover is customer due diligence and beneficial
7 ownership requirements. The rule was issued by the
8 Financial Crimes Enforcement Network, the
9 Administrator of the Bank Secrecy Act in May of
10 2016.
11 And there was a two-year period within
12 which banks and securities brokers and dealers
13 could establish systems, policies, procedures, et
14 cetera to become compliant with customer due
15 diligence, I'll call that CDD, and beneficial
16 ownership requirements.
17 I would like to say up front, I think
18 banks are really good at customer due diligence.
19 You've always done customer due diligence. You
20 know through underwriting, you know, what the
21 expectations are associated with the repayment of
22 loans. You know your customers certainly on the

1 asset side of the balance sheet.
2 Sometimes different standards have
3 applied to the deposit side. So this really takes
4 all of our expectations and codifies them in terms
5 of customers on any side of the balance sheet.
6 So we have had written guidance in place
7 since 2005, and that's the first time we issued the
8 FFIEC, Federal Financial Institution Examination
9 Council, Bank Secrecy Act Anti-Money Laundering
10 Manual.
11 So we've had the guidance in place, but
12 this really codifies it. That's the customer due
13 diligence piece. The new requirement, however, is
14 to collect beneficial ownership information for
15 legal entity customers.
16 This has created a lot of feedback from
17 the industry. And over this 24-month period, not
18 only have we joined FinCEN in meeting with bankers,
19 with trade groups, et cetera, just understanding
20 what the concerns have been, but we reviewed
21 frequently asked questions that they ultimately
22 issued to deal with a lot of these questions.

1 So just like the last presentation, you
2 do have a slide deck if you want to refer to it now
3 or later, or whatever you would like to do with it.
4 But I'm on slide two.
5 So as I mentioned, the rule codified
6 customer due diligence expectations. And the
7 FDIC, along with the other banking agencies, we
8 issued the procedures, the overviews and the
9 procedures May 11th of 2018.
10 So what our examiners will be doing in
11 your institutions, you've got the roadmap. You
12 understand the overview and you've got the
13 procedures. So just in the spirit of full
14 transparency, we do that and we make our manual
15 public. These are two new chapters in the manual.
16 What does customer due diligence do?
17 Well, it requires a bank to understand the nature
18 and purpose of customer relationships for
19 developing a customer risk profile. Makes perfect
20 sense to me, and I'm sure to you, as well.
21 But it also requires conducting ongoing
22 monitoring to identify and report suspicious

1 activities, which has been an obligation for a
2 number of years, and it requires that banks update
3 and maintain customer information on a risk basis.
4 So there is some subjectivity clearly in
5 the rule. It's not like a capital threshold, there
6 is some subjectivity. So understanding the nature
7 and purpose of the relationship makes sense.
8 Adjusting data that you collect based on risk also
9 makes sense to me. So these are things that banks
10 have been doing for a long time.
11 Moving on to our procedures, what should
12 you expect examiners to be looking for? Well,
13 they're going to look at the bank's risk profile.
14 And where do we get that information? We get it
15 from your risk assessment.
16 Banks have Bank Secrecy Act/Anti-Money
17 Laundering risk assessments and have for a number
18 of years. And for the most part, that is our
19 roadmap to understand where the bank has identified
20 higher risk products, services, customers,
21 entities, and where they operate.
22 So the bank really provides the roadmap

1 for us essentially to start our transaction
2 testing, to look at accounts or customer
3 relationships that the bank has identified as
4 higher risk.
5 For policies and procedures, we'll look
6 to make sure that the bank has identified
7 responsibilities of staff members, that the
8 policies and procedures provides for documenting
9 customer due diligence analysis, and addresses how
10 customer information will be used, and if there's
11 a problem in collecting information, how those
12 deficiencies will be addressed. So it's really a
13 comprehensive customer due diligence policy.
14 In terms of how the information will be
15 used, generally customer information is used for a
16 lot of purposes. But for suspicious activity
17 monitoring, for identifying somebody that is on the
18 Office of Foreign Assets Control Specially
19 Designated Persons List, so those are -- and you
20 know drug kingpins, individuals that have been
21 identified by OFAC as creating some significant
22 problems for the U.S.

1 So this information is helpful in
2 identifying those individuals, as well. So that
3 was the easy part. Now beneficial ownership
4 information is a new requirement, and this is where
5 we've received the most feedback.
6 This has been established to remove kind
7 of the obfuscation, or to remove the ability of
8 individuals to shield themselves behind a corporate
9 identity. So if an institution has a legal
10 customer, the expectation, now the requirement, is
11 to collect beneficial ownership information.
12 Well, what does that mean? Definitely
13 it means that they need to collect the name of
14 somebody who influences control in the institution,
15 something like an executive in most institutions
16 that we supervise. So they need to collect that
17 name.
18 Second, they're going to need to address
19 the ownership prong. So the ownership prong is an
20 individual that owns 25 percent or more of the
21 equity interest in the legal entity.
22 If there is nobody that owns 25 percent

1 or more, they will have the individual who exercises
2 control over the institution, and that's it. But
3 they could have up to five beneficial owners.
4 Let's just say there are four
5 individuals that each own 25 percent, and then there
6 is somebody who exercises influence that is not one
7 of those equity interest holders. So banks should
8 be collecting that information as of May 11th, 2018,
9 for newly- established relationships.
10 It is not retrospective. There is not
11 an expectation or a requirement that you go back and
12 fill in the information, unless there's some type
13 of triggering event and you have reason to believe
14 that you need the information, and you would need
15 to collect that information. But this is a going
16 forward regulation. So you don't --
17 MEMBER SCULLY: Except as I understand
18 it, if you've got, for example, live credit
19 information, and the question is would that include
20 something like an overdraft line for a smaller
21 company that that renewal triggers an event where
22 you now have to gather it.

1 MS. ARQUETTE: So that's a great
2 question, and that's the question that we've heard
3 most frequently. What about loans that are account
4 relationships, or CDs that are account
5 relationships that automatically renew.?
6 So an overdraft protection feature or a
7 CD that automatically renews, just a very short-
8 term CD, do you have to keep collecting that
9 information.? The first answer from FinCEN is yes,
10 you do.
11 The second answer on May 16, of 2018,
12 was that they granted acceptive relief for 90 days
13 while they consider the issue because it has been
14 raised frequently about these automatically
15 renewing instruments. So they're considering it
16 right now because it is a real practical issue that
17 is faced by banks.
18 Now, if you have information and you
19 believe that it's correct and nothing's changed,
20 you don't have an obligation to go back and ask for
21 the information again. You likely have the
22 information going forward. So that's something

1 that is under consideration.
2 They've been pretty responsive to
3 industry questions and issues that have been
4 raised, and that's a good example of taking a step
5 to deal with that.
6 MEMBER SCULLY: And does somebody
7 answer the questions, or is it that they consider
8 the questions and modify their responses. You
9 don't need to --
10 (Laughter)
11 MS. ARQUETTE: Thank you. Well, they
12 have issued two sets of FAQs, one shortly after the
13 rule was issued, I believe it was in June of 2016
14 and then another set of FAQs in April of this year.
15 So I think they actually have responded
16 to a lot of concerns that have been raised by
17 understanding the mechanics behind a lot of
18 relationships, responding to beneficial ownership
19 questions, and just dealing with the true
20 implementation issues that are being faced.
21 So you jumped ahead, but that's okay.
22 So that's a good question to raise.

1 MEMBER MENON: With an existing
2 relationship opening a new account, does that
3 affect that? You know, if there is a renewal of it
4 or just a new account?.
5 MS. ARQUETTE: New accounts you should
6 be --
7 MEMBER MENON: But an existing
8 relationship.
9 MS. ARQUETTE: So here's another great
10 question. What if something like this, you had a
11 legal entity that opened multiple accounts, so
12 going forward they open an account, you collect the
13 beneficial ownership information, but they open
14 several accounts for different business purposes.
15 Do you have to keep collecting it?
16 No, unless you have reason to believe
17 that you need the information, that there was a
18 triggering event that the individual who controlled
19 the entity has changed. You might get that
20 information on the loan side or just by reading the
21 newspaper.
22 But you might have reason to believe

1 that you need to ask for the information again. So
2 if you have multiple accounts and you've already got
3 the beneficial information for the first account
4 that opened after May 11th, you don't have to keep
5 going back and asking for it unless you have reason
6 to believe that something has changed. Okay.
7 MEMBER TURNER: And so you don't have to
8 see evidence, I mean, you just ask them who owns the
9 company?
10 MS. ARQUETTE: Well, it is --
11 MEMBER TURNER: You don't have to see
12 stock certificates?
13 MS. ARQUETTE: That's another really
14 good question. It can be fairly simple. FinCEN
15 provided a certification form when they issued the
16 rule.
17 So the individual entering the
18 institution and establishing the account, maybe
19 it's a deposit account, maybe it's a loan, they
20 enter the institution, represent the legal entity,
21 whatever it is, ABC Company, a corporation, a
22 limited liability company.

1 And they say I'm the CEO, I am the
2 beneficial owner and there are no individuals that
3 have 25 percent ownership interest, and they
4 certify it. So you've got certification that
5 you've collected. It really can be that simple.
6 Now if a bank wants to take additional
7 steps and you have internal policies and procedures
8 that would cause you to ask for more information,
9 that's perfectly fine. That's an internal
10 decision.
11 Do you have to go back and validate
12 articles of incorporation, look for some kind of
13 verification that individual A owns 25 percent?
14 No, it's an attestation by the individual opening
15 the account and a certification, signing a
16 certification who the beneficial ownership is.
17 Beneficial owner, excuse me.
18 MEMBER TOLOMER: When somebody creates
19 an LLC, wouldn't it be more practical for them to
20 provide that information rather than to come to the
21 banks and expect us to get the information?
22 MS. ARQUETTE: You mean provide it to

1 the state where they established the LLC? There
2 are --
3 MEMBER TOLOMER: It would be logical.
4 MS. ARQUETTE: There are countries that
5 collect information on a centralized basis. We're
6 not part of that group right now, and it makes sense
7 for, you know, a lot of countries to have a
8 centralized location. That has been raised
9 several times. Right now the obligation is --
10 MEMBER TOLOMER: Banks.
11 MS. ARQUETTE: -- the bank's
12 obligation, securities brokers, and dealers, also.
13 MEMBER SCULLY: For economic reasons I
14 would suspect. They don't have to pay us to collect
15 it.
16 MS. ARQUETTE: Thank you. Thank you.
17 That was a rhetorical statement, thank you. Any
18 other questions related to customer due diligence
19 or beneficial ownership?
20 I did mention during the first session
21 that we planned to have an industry call, webinar,
22 to go over this topic in more detail. When we have

1 these calls, we are joined by FinCEN who addresses
2 the technical issues associated with the regulatory
3 requirements.
4 They deal with the beneficial ownership
5 issue. We generally will talk about the overview
6 and examination expectations. So I would
7 encourage you to look for the notice when we set that
8 up.
9 It promises to be probably a very
10 interesting meeting, especially since banks will
11 have had some experience in this area leading up to
12 the webinar.
13 MEMBER SCULLY: And what is the
14 expectation? And maybe you said this, but what is
15 the expectation that at some point you have to get
16 to a human being?
17 MS. ARQUETTE: Well, you --
18 MEMBER SCULLY: In certain
19 transactions, you know, there are trusts or other
20 LLCs or partnerships that hold the beneficial
21 ownership.
22 MS. ARQUETTE: Another good question.

1 So if you've got a sole proprietorship you already
2 know who the owner is, right? If it's a trust, now
3 that has been excluded from the definition of a
4 beneficial ownership requirement. So FinCEN has
5 laid out the exceptions.
6 And you're not going to find articles of
7 incorporation, so an LLC, a corporation, if it was
8 just an arrangement, an agreement between a group
9 of people, you're not necessarily, you're not
10 obligated to provide the beneficial ownership of
11 this arrangement that is informal.
12 So they've, I think, done a fairly good
13 job up to this point of identifying where there are
14 some carve- outs.
15 MEMBER DONNELLY: Has there been any
16 benefit analysis or cost analysis on cost- to-
17 benefit? Has the FDIC done any of that? Is there
18 anything in the background that says let's "Let's
19 look at this?"
20 MEMBER SCULLY: In fairness, they're
21 just responding to FinCEN.
22 MEMBER DONNELLY: I understand that.

1 MEMBER SCULLY: And you weren't here a
2 couple of years ago. FinCEN gave a presentation
3 and when they were specifically asked if based on
4 all of these millions and billions of pieces of data
5 that they had accumulated at our expense, whether
6 or not they could provide some better statistical
7 analysis of how to do something other than look over
8 your shoulder blindfolded and throw a hatchet as
9 opposed to a more finite dart, they were unable or
10 unwilling to answer that question and literally
11 pulled out the terrorist card in their answer.
12 MS. ARQUETTE: They did do a cost
13 analysis that's part of the rulemaking process. I
14 think they actually went through it twice. The
15 second time was pretty rigorous. And again, it's
16 only an estimate about how much it will cost versus
17 the benefits. So I will pass along the comments
18 from today.
19 CHAIRMAN MCWILLIAMS: Could you maybe
20 send Chris the cost-benefit analysis that was done?
21 MS. ARQUETTE: I sure will.
22 CHAIRMAN MCWILLIAMS: Thank you.

1 MR. DAVIS: Well, I was just going to
2 say we do have a few more minutes before we're
3 scheduled to break for lunch since I had to cut off
4 debate in the prior session.
5 I guess I would say if there's any
6 questions over either session, we do have a few
7 minutes if somebody would like to bring something
8 up.
9 MEMBER DAKRI: If I could just make a
10 comment on the disaster recovery. You know, I look
11 at the guidance here and I understand that we have
12 to have some type of guidance for the examiners.
13 But my comment would be if we could have,
14 make sure the examiners give a little bit of leeway
15 to the banks that are involved in these type of
16 things. You know, we went through it in Houston
17 with Harvey, and when these things happen, you just
18 do whatever you have to do to get things done.
19 You know, paperwork might not be great,
20 everything might not be ticked and tied and in the
21 right spot, but you're trying to help the customer
22 out, do whatever they can.

1 And so if there can be some leeway from
2 the regulatory agencies to make sure that, hey,
3 we're not going to criticize you for this. You
4 know, we were fortunate. We had, a week after
5 Harvey hit we had a safety and soundness exam. Six
6 months after that we had a compliance exam.
7 So some of the questions that came up on
8 the compliance in particular was your documentation
9 is a little bit vague here for giving these people
10 six months of no payments or whatever it was.
11 Okay, yes it was vague. I apologize.
12 But the only thing that I could say was I asked FDIC
13 and here's my response, here's the email. So you
14 tell me what I was supposed to do. But you know,
15 if there can be something from the examination
16 standpoint to say, you know, give them a little
17 break, make sure that we're not too critical.
18 And when I looked at this document here
19 I noticed on management it said analyze management,
20 how they reacted, what they did. Now my only point
21 I want to make here is that okay, we had been through
22 it, we've gone through it.

1 But 99 percent of the banks will never
2 go through it. So how do you utilize that
3 information for the bank that does go through it and
4 criticize them when you have no opportunity to
5 criticize the other 99 percent?.
6 MS. EBERLEY: So the point of that
7 guidance is to not criticize. The point of that is
8 to --
9 MEMBER DAKRI: Right, but it does say
10 you should --
11 MS. EBERLEY: -- you know, understand
12 --
13 MEMBER DAKRI: -- analyze and look at
14 and da, da, da.
15 MS. EBERLEY: Sure.
16 MEMBER DAKRI: And human nature is
17 you're going to put those comments in the report
18 about this should have been done better or that
19 could have been done better.
20 And so while I understand it's not meant
21 to be a criticism, it's you're looking at something
22 that happened and giving commentary and criticism

1 if you will, constructive criticism about maybe you
2 should change this, change that, change that.
3 Now you're holding a management team
4 that's gone through it to a slightly different
5 standard than the 99 percent of the other banks that
6 are in the country that don't go through this
7 process. So that's my only comment is I think there
8 needs to be a little leeway that these things don't
9 ever end up in a report anywhere.
10 It's more of a learning process not just
11 for the banks but for the FDIC, for OCC, whoever the
12 regulatory agency is that that takes place because
13 I look at this and I can tell from my experience I'm
14 like wow, this is going to get into a report and
15 there will be some commentary about, you know, what
16 did they do with staffing, what did they do with
17 this, what did they do with that.
18 You know, all these type of items are
19 listed here. I think it just would end up in a
20 report or in some commentary of a report.
21 MS. EBERLEY: Yes, and very well. But
22 again, hopefully from a positive perspective. You

1 know, this is what management did to respond, this
2 is how management took actions with the point being
3 that so let's just say you're in a marketplace where
4 you've had asset deterioration because your
5 borrowers have, you know, lost values and they
6 didn't have flood insurance.
7 And so you're experiencing asset
8 quality problems which are turning into earnings
9 problems which are maybe impacting your capital.
10 You know, management is giving borrowers leeway to
11 try to work with them as we've requested that you
12 do when we send out the guidance right after a
13 disaster and say please work with your customers.
14 Things usually end up better in a
15 situation like that when bankers are giving
16 borrowers some assistance, you know, deferrals of
17 payments, those sorts of things working with
18 borrowers as they respond to the emergency
19 situation.
20 Point well taken, and you know, we'll do
21 some follow-up and make sure. Every report of
22 examination is reviewed at a regional office by a

1 case manager who's trained to prepare, to conduct
2 that review.
3 So if the policy weren't being carried
4 out properly, we would expect that it would be
5 caught at that level. And we would ask that if you
6 experience any difficulties at all, you know, let
7 us know because that's certainly not the intent of
8 the guidance.
9 The guidance is intended to give
10 management that kind of deference for the kinds of
11 decisions you have to make in a critical situation
12 where your focus is on helping your customers, your
13 community respond to a disaster.
14 MEMBER DAKRI: I think the point I was
15 just trying to make is give the bank a little bit
16 of, you know, leeway saying not a problem because
17 while some people go through it unfortunately,
18 other people don't have a chance to and you look at
19 contingency plans and whatnot.
20 They're only as good as they're written
21 on a piece of paper until you have to use them. So
22 most people never have to use them.

1 MS. EBERLEY: Yes.
2 MR. DAVIS: Anything else? Okay.
3 MEMBER WILLIAMS: There was a question
4 earlier where I think it came up down here on FDIC
5 insurance costs and what have you. And I don't know
6 what the correlation or how it works between the
7 examination group and whoever sets those rates.
8 But just an interesting kind of personal
9 phenomenon on that. We went through the process,
10 exam was first of the year. Rated well, we'll put
11 it there. And you know, we set our budget.
12 And then after the exam we had a bump in
13 FDIC costs which our rating had not changed and
14 such. And the reason was some concentration.
15 Okay, I understand credit concentration, but what
16 we didn't have was the other side of the discussion
17 to talk with anyone or have an opportunity to appeal
18 that.
19 There may be and it may be something I'm
20 unfamiliar with, but you know, what they didn't know
21 we did is we put a mandatory minimum PCE capital
22 number in there of eleven and a quarter percent.

1 We increased our risk based to 15
2 percent and the concentration in the ADC area we put
3 an 80 percent of it was in vertical construction in
4 residential that has zero standing inventory in the
5 market right now. Pretty safe stuff.
6 So you know, we look at CAMELS rating
7 being what it is and we assume a rate there, but
8 there's one, a trigger, but we're not able to look
9 at the other side of the trigger that where we put
10 in some safety mechanisms to ensure that there
11 wouldn't be any more risk to the FDIC fund.
12 How does that work or how do we interact
13 with the FDIC on those kind of issues?
14 MS. EBERLEY: So you're talking about
15 the deposit insurance pricing model?
16 MEMBER WILLIAMS: Yes, yes.
17 MS. EBERLEY: Which is handled by our
18 Division of Insurance and Research. They're going
19 to be talking later this afternoon about assessment
20 credits. We don't have a lot of time. I don't know
21 if Diane's in the room right now, if we'll be able
22 to talk about that.

1 But if we can't talk about it today, it
2 certainly is something --
3 MEMBER WILLIAMS: No, I'll find
4 discussion or something.
5 MS. EBERLEY: Oh, and we can also put it
6 on the agenda for next time to have a presentation
7 about the small bank deposit insurance pricing
8 model, how it works, what the nuances are.
9 So the CAMELS components are one factor.
10 Financial ratios are another factor. And so all
11 those things work together. But we could certainly
12 have a conversation about that at a future meeting.
13 MEMBER WILLIAMS: Thank you.
14 MS. EBERLEY: And see what we can answer
15 this afternoon.
16 CHAIRMAN MCWILLIAMS: And maybe we can
17 give him some information on the appeals process.
18 MS. EBERLEY: Absolutely. And so
19 there is an assessment appeals process as well, like
20 you appeal your safety and soundness examination
21 findings.
22 MR. DAVIS: Great.

1 (Off microphone comments.)
2 MR. DAVIS: Okay, we're going to break
3 until 1:30 for lunch, and we'll see everyone back
4 here at that point.
5 (Whereupon, the above-entitled matter
6 went off the record at 12:18 p.m. and resumed at 1:32
7 p.m.)
8 CHAIRMAN MCWILLIAMS: All right, I
9 think we can get started for the afternoon session
10 now that everybody is all fed and caffeinated.
11 MR. DAVIS: Okay. I don't have a
12 gavel, so I'll just kind of --
13 CHAIRMAN MCWILLIAMS: You know what?
14 I am bringing the gavel.
15 MR. DAVIS: So we thought we'd start
16 this afternoon with providing the committee with a
17 community bank research update. From the FDIC's
18 Division of Insurance and Research, we have Diane
19 Ellis, the director, Patrick Mitchell, the deputy
20 director of Risk Analysis and Pricing and George
21 French, acting deputy director for the Office of the
22 Chief Economist and Regulatory Analysis Branch.

1 Diane is going to highlight the
2 publication of Crisis and Response: An FDIC History
3 2008 to 2013. Then Pat is going to review the
4 quarterly bank performance results for community
5 banks. And finally George will discuss the broader
6 financial trends for community banks. Diane?
7 MS. ELLIS: Thanks, Chad. Good
8 afternoon everyone. I'm not going to take up too
9 much time. But before I do turn it over to Pat and
10 George, I would like to say a few words about the
11 book that you have in front of you.
12 This study was published late last year
13 and reflects the FDIC's unique perspective and role
14 in the financial and banking crisis and our response
15 to their challenges. We wrote it with the
16 intention of complementing the growing literature
17 on historical accounts of this period. And it's
18 intended to not only inform policy makers now, but
19 hopefully it will be useful to those who may be
20 confronted with similar challenges in the future.
21 We organized it into -- you'll see that
22 we organized it into two parts. Part 1 documents

1 the origins of the financial crisis and the steps
2 the FDIC took to respond to it. So it includes a
3 chapter on our Temporary Liquidity Guarantee
4 Program, which you might recall included a
5 guarantee of newly issued debt. And then unlimited
6 coverage of certain non-interest bearing
7 transaction accounts. And it also describes our
8 use of what we call our systemic risk authority to
9 provide open-bank assistance to some of the largest
10 institutions at the time.
11 Part 2 covers what we describe in the
12 book as sort of the follow- on banking crisis, which
13 was -- felt more like say the crisis of the 80s and
14 early 90s. And it highlights the challenges the
15 FDIC faced in carrying out our core mission of
16 supervision, deposit insurance and failed bank
17 resolution. And has a chapter each on those
18 functions.
19 We felt like the time was right to
20 prepare such a study, given that it's been, believe
21 it or not, ten years since the onset of that
22 financial crisis. And we felt like we still had

1 enough staff around here with firsthand knowledge
2 of what went on. So before they all got away, it
3 was important to document that.
4 And we also felt like preparing a study
5 and releasing it to the public was a way for us to
6 learn not only what we did well, but what we could
7 have done better. So that's the point is to spark
8 conversation about that. And we're happy to
9 provide you all a copy with the study today. And
10 hope that you find it useful. And if you do have
11 time to read it, love to get your feedback on it.
12 So that's --
13 (Simultaneous speaking)
14 MS. ELLIS: Yes. All right. So with
15 that, I will now turn it over to Pat. Pat?
16 MR. MITCHELL: Sure, thanks Diane. So
17 good afternoon. I have the opportunity today to to
18 talk to you about the first quarter results. If you
19 will, there's actually a slide deck in here that
20 I'll use because I think pictures work very well in
21 depicting results. It's under, I believe, in the
22 community bank research section. And it's a slide

1 that hopefully says community bank -- slide that
2 says community bank performance first quarter 2018.
3 So I'm going to take probably about ten
4 minutes to go over these slides. And as you may
5 recall in 2014, the FDIC added a section to its
6 quarterly banking profile that focused
7 specifically on community banks. And so as
8 reported here and as shown in the slide deck, we've
9 defined community banks using the FDIC definition.
10 Which is focused on activities, location, branches,
11 as opposed to just using size.
12 So with that, I'll turn to Slide 2
13 please. So this shows higher quarterly earnings.
14 First quarter was a very positive quarter for
15 community banks with continued -- showing continued
16 demonstrated progress and continued improvement.
17 The net income was up almost 18 percent
18 over a year ago. The primary drivers are really net
19 interest income, which was up almost ten percent,
20 non-interest income up mildly 3three percent. And
21 then income taxes was a large contributor this
22 quarter, as they declined by 22 percent given the

1 new tax bill and the lower corporate tax rate.
2 So that was a contributor that we're
3 going to have some comparability issues as we go
4 quarter over quarter over the next year, up until
5 first quarter '19 when we're more normalized. And
6 that noise, if you will, will be removed.
7 On the expense side, non-interest
8 expense was up almost 7 seven percent. And
9 provisions were up almost 24 percent, but I'd
10 highlight, that's off a very low base. So the
11 provisions have been relatively low. So even
12 though it's a large percentage increase, we didn't
13 view that as anything abnormal or any type of -- any
14 real takeaway from that.
15 The improvement was also broad-based
16 across the industry. So almost seven out of ten
17 community banks reported higher earnings than a
18 year ago. So it wasn't just 50 percent doing well.
19 It was a broad-based improvement.
20 And then if you look at the chart at the
21 bottom right, NIM. The chart shows that NIM
22 improved almost ten basis points up to 3.64 percent.

1 And it remained materially higher than the industry
2 NIM at 3.32 percent. So community banks continued
3 to outperform the industry in terms of net interest
4 margin.
5 So on to Slide 3. Slide 3 focuses on
6 pre-tax ROA. And here the industry -- the
7 community bank remained relatively flat at 1.33
8 percent. Pre-tax ROA, it remains well below the
9 industry average of 1.62 percent. I would note
10 that, that gap has remained pretty steady
11 post-crisis. And it's largely due to the amount of
12 non-interest income generated by some of the larger
13 institutions that generates that difference.
14 Looking at the chart in the lower right,
15 revenue as a percentage of assets is at 4.22
16 percent, up 4 four basis points from a year ago.
17 What I find interesting on this chart is that
18 really, it's been pretty range-bound. Some ups and
19 downs quarter to quarter, but no real -- I'd say
20 there's no real material trend in that number. It
21 appears to be fairly stable. This increase over
22 the last quarter was driven by an increase in net

1 interest income of 10 basis points.
2 So Slide 4. This is more of a good
3 story. Asset quality remains strong. The
4 non-current loan rate is down to 0.85 percent for
5 community banks. And this is the lowest level
6 since 2007. Using a little gallows humor, we know
7 what happened post 2007. We hope that's not going
8 to repeat itself. But it is showing very strong
9 credit quality and loan performance.
10 I would also note that across all loan
11 categories --, or most loan categories, they saw
12 declines in their non-current loan rates. With two
13 exceptions and these are areas we're certainly
14 focused on. Farmland and agricultural production
15 loans. For those of you that are active in the
16 area, certainly ag loans are an area of focus. And
17 an area where we know that there's some level of
18 stress. And you know, prices have continued --
19 recently have seen some volatility. So we're going
20 to continue to watch that performance, as I know you
21 all will.
22 Looking at the chart in the bottom

1 right. Looking at net charge-offs, the net
2 charge-off rate is up over the last year, but not
3 significantly. It's up from 0.11 percent to 0.13.
4 So it's really a small tick up and that's primarily
5 been driven by C&I loans. You'll see the line there
6 showing the credit card charge-off increase, but
7 that's really not a significant part of the
8 community banking portfolio.
9 On to Page 5, Slide 5.
10 MEMBER KELLY: Excuse me.
11 MR. MITCHELL: Sure.
12 MEMBER KELLY: Is there a certain
13 portion of C&I that seems to be bumping or not or
14 when the charge-off from the C&I is up? I mean is
15 there a certain --
16 MR. MITCHELL: And again, it's from a
17 low level. We're not really seeing -- And again,
18 we're a little bit constrained by data, so we're not
19 really seeing any one area that we would point to.
20 We do know that there's some recurring -- it can
21 still be related to some of ag downturn and also some
22 of the energy. So there's a little bit of residual,

1 though we haven't seen a huge tick up there, either.
2 So it's notable in that it's the only one -- only
3 major loan category that really ticked up. Not
4 notable necessarily in its size.
5 MEMBER WILLIAMS: Are there are any
6 geographical differences or significant
7 differences in these charts that are national?
8 MR. MITCHELL: Again, nothing that
9 really jumps out. But of course there's some in the
10 Kansas City region.
11 MEMBER WILLIAMS: Okay.
12 MR. MITCHELL: Some in the Dallas
13 region that are showing up because of the ag. And
14 still some again marginal residual from the energy
15 downturn.
16 So on Slide 4. Oh, sorry. On Slide 5,
17 we moved on. So loan growth. Again, this has been
18 a very strong story for the community bank. Loan
19 growth remains strong, 7.4 percent. It's much
20 greater than the industry. The industry is at 4.9
21 percent annual growth. And that's also for some
22 period of time, the community banks have exceeded

1 the industry. And also have well exceeded GDP
2 growth. So this is part of the story that's been
3 going on for some period of time. Really it seems
4 that loan growth is strong. And community banks
5 are having the opportunity to make loans.
6 It's also been broad based across all
7 major loan categories. The highest growth has been
8 driven by what we call non-farm, non-residential.
9 But as well all know, essentially CRE, so commercial
10 real estate. So that's been the primary driver of
11 the -- or a significant driver of the largest grower
12 across the major loan categories.
13 Looking at the chart on the right, and
14 George is going to touch on this a little more in
15 depth, but the trend of loans to assets at community
16 banks have been very -- it's been a sustained trend
17 since hitting the low of 62 percent in 2012, up to
18 today's loan-to-asset ratio of a little over 70
19 percent. It's been sustained and it appears to be
20 strong.
21 The industry's at 56 percent and you'll
22 see there that -- you know, that's been a little

1 flatter and it's been less pronounced. There's
2 been a small tick up but nothing that I would --
3 nothing that I would mark. So there the community
4 banks have definitely been growing their loans as
5 a percentage of assets relative to the industry.
6 Feeds into the loan story.
7 So now on page -- last slide. So the
8 last slide is a bit of a note of caution. The
9 interest rate risk has increased significantly for
10 community banks since 2010. Focusing on the
11 liability side -- so the upper right chart first.
12 The chart shows what I want to focus on are the time
13 deposits and the maturity schedule. And those are
14 the solid and dashed black lines. So those
15 represent time deposits by maturity. But even
16 looking at them in total -- if you look at them in
17 total, total time deposits have declined from 37
18 percent of total assets to 22 percent of assets.
19 I'm telling you a story I think you all
20 know, and you've lived it. So this isn't
21 necessarily news, but it does show up on the charts.
22 The interest rate environment just hasn't been

1 conducive to really attracting time deposits. And
2 I'm sure you -- not a whole lot of people have
3 interest in locking up their deposits for a long
4 period of time at extraordinarily low rates.
5 However, as rates rise, of course this
6 exposes to repricing risk. And to date, at least
7 in aggregate, we really haven't seen that much of
8 a repricing of deposit liabilities. It certainly
9 hasn't kept pace with the pace of rate increases
10 from the Federal Reserve. And so we all hear about
11 the deposit betas. They've been relatively low.
12 But at some point in time, that's going to be
13 unsustainable and there will be more competition
14 than we expected. The deposit pricing will start
15 ticking up.
16 So now looking at -- pairing that off
17 with the chart on the lower right. Community banks
18 have been increasing their percentage of long-term
19 loans and securities. And for this purpose, when
20 we say that, it's really for those loans or
21 securities that re-price or mature in more than
22 three years.

1 So in 2010, community banks had
2 approximately 37 percent of their total assets that
3 repriced in three years or later. That's now
4 increased to approximately 50 percent. It appears
5 to have plateaued. It appears to have leveled out
6 at this point in time. But it’s grown
7 significantly since 2010.
8 So pulling those two together, the story
9 we have is increasing interest rate risk, with
10 community banks having gone out longer on the
11 interest rate curve on the asset side. And then
12 having more deposits that are susceptible to
13 repricing quicker. So it's certainly an area that
14 we're focused on. And I know the supervisory
15 attention I wanted to highlight for you.
16 So that's the community banking
17 performance. I'm happy to take questions now, or
18 I can hand it over to George and we can handle
19 questions in whole. All right, George?
20 MR. FRENCH: Thanks. All right, well
21 good afternoon.
22 MEMBER TURNER: Sorry. So given what

1 you said, as you hear back from examiners that do
2 the, you know, sensitivity examinations at banks,
3 are you hearing that there are a lot of banks that
4 are actually liability sensitive when you, you
5 know, include the effective beta factors and other
6 items?
7 MR. MITCHELL: You want to take a shot
8 at it George?
9 MR. FRENCH: I'm sort of sitting here --
10 MR. MITCHELL: George gets to wear two
11 hats. He gets to wear two hats.
12 MR. FRENCH: So I used to be in
13 full-time job supervision. So clearly interest
14 rate risk is a big focus of our examinations. And
15 you know, I would say we've been pretty pleased with
16 the fact that institutions seem to be, you know,
17 taking heed of the supervisory findings. And I
18 think we have sort of an outlier type approach where
19 we look at institutions that are more exposed in
20 terms of maturity gap. And we're starting to see
21 that come down a little bit in terms of the trend.
22 So I think institutions are clearly paying

1 attention to the risk.

2 So with that, I can jump into the next
3 deck which looks like this. It should be right next
4 to the deck that Pat just went through. So clearly
5 we have strong bank performance at this time.
6 According to the National Bureau of Economic
7 Research, we're currently in the second longest
8 U.S. economic expansion since the Civil War. So
9 times are pretty good. Of course, we saw times were
10 pretty good before the last crisis. So you know,
11 we thought it would be interesting to look at some
12 of the similarities and some of the differences.
13 How does the current expansion for banks -- for
14 community banks -- compare to the last expansion?
15 And, hopefully, provide some food for discussion
16 around the table.

17 So looking at the first slide, which
18 deals with capital, you know this is clearly an area
19 of strength for community banks. This chart is
20 sort of a now versus then comparison. So you see
21 you a dark blue line which is the leverage ratio for
22 community banks in the last four years. The light

1 blue line is the ratio before the crisis -- the four
2 years before the crisis. So you sort of see the two
3 time periods are stacked one on top of the other on
4 the horizontal axis. That will be the format for
5 a number of these slides.
6 So, basically, community banks are
7 operating now with a percentage point more in terms
8 of their leverage ratio than they did before the
9 crisis. It certainly dipped during the crisis
10 about 70 basis points, but it's since rebounded
11 strongly. And it's now one of the areas of strength
12 for the industry. In part because of the fact that
13 they have higher capital, their measured
14 concentrations of commercial real estate and
15 construction are now lower than they were.
16 So we'll go onto the second slide. So
17 this shows the percentage of community banks that
18 either had commercial real estate or construction
19 lending concentrations -- commercial real estate
20 greater than 300 percent of capital or construction
21 lending greater than 100 percent of capital. You
22 can see that at the peak, 32 percent of community

1 banks had CRE concentrations, 26 percent had
2 construction lending concentrations. And those
3 numbers have come way down.
4 So, for example, now only 6six percent
5 of community banks have concentrations in
6 construction lending exceeding 100 percent of
7 capital. So again in part because of the increase
8 in capital, those concentrations are going to go
9 down. But it's also just that the concentrations
10 have come down. A number of institutions were
11 burned during the crisis. And the concentrations
12 are significantly down, even for those that have the
13 concentrations, the levels of concentrations are
14 lower. Now I do want to point out that it is not
15 the case that banks are not lending in these
16 categories. I'm going to come back to that a little
17 later.
18 Going on to Slide 3, and Pat touched on
19 this. One of the factors that's been supportive of
20 net income performance during this current cycle
21 has been the plentiful low-cost deposits. So this
22 slide, for example, shows the percentage of

1 deposits that are non-interest bearing. And
2 again, the dark blue line being now. -- light blue
3 line before the crisis. Significantly more
4 non-interest bearing deposits now. And that helps
5 the bottom line.
6 And of course the flip slide, and sort
7 of the potential for a two-edged sword, is that
8 banks have -- those banks that have gotten used to
9 this and have come to rely on it, as interest rates
10 start to rise and deposits start to re-price or they
11 leave the bank if they don't get the higher price,
12 that creates either a squeeze on net interest margin
13 or potential for deposits leaving the bank.
14 And we'll go on to the next slide, which
15 sort of is a spot to elaborate on some of these
16 issues. Slide 4. And this really simply
17 reinforces what Pat was saying about the maturity
18 mismatch.
19 So the dark blue line and the light blue
20 line represent the portion of assets with
21 maturities greater than three years that are funded
22 with liabilities that are less than three years in

1 maturity. And you can see there's about a 15
2 percentage point difference. There's
3 significantly more long maturity assets today than
4 there was during the pre-crisis period. And of
5 course that raises the prospect again as interest
6 rates increase, those long-term assets, they're
7 locked in. They're not going to re-price.
8 And so as the deposits increase in cost,
9 that puts a squeeze on the spread. And then
10 potentially those long-term assets will decrease in
11 value as rates rise, which also creates a liquidity
12 issue potentially.
13 So again, just simply reinforcing what
14 Pat was saying. I think clearly it points at when
15 we're looking at similarities and differences,
16 interest rate risk is one of the more -- is one of
17 the challenges in the current environment that
18 maybe wasn't as prevalent during the last cycle.
19 Going onto to credit risk, which is you
20 know, last but not least. And this is Slide 5. So
21 notwithstanding that I just got through saying that
22 concentrations in commercial real estate and

1 construction lending are down relative to capital,
2 nonetheless, the overall volume of loans and
3 loan-to-asset ratios are now a little bit higher
4 than they were before the crisis, surprisingly
5 enough.
6 And it really is in a number of areas,
7 you know, I think one-to-four family non-farm,
8 non-residential continue to be important. The
9 composition of loans today at community banks, more
10 than half are collateralized by real estate, which
11 is same as it was before the crisis. A little less
12 construction now. A little more general
13 commercial real estate.
14 So you see here, you have more loans. I
15 didn't show that there are fewer investments, but
16 in fact, there's also less liquid assets. So more
17 loans, less investments, a little more credit risk,
18 a little more liquidity risk. And I think probably
19 it's a function of the low interest rate
20 environment. The banks are looking for higher
21 yielding assets to shore up earnings.
22 So again reflecting on comments that Pat

1 made, I think the story on lending has mainly been
2 the loan growth in the last few years. And I'll
3 turn to Slide 6.
4 So lending at FDIC-insured banks in
5 general has been outpacing GDP growth for some time.
6 But it's particularly true for smaller banks. And
7 this chart deals not strictly with community banks
8 but all those banks with assets less than 100
9 billion, which includes both community banks and
10 many of the banks that community banks compete with.
11 And you can see that all these banks are on average
12 growing their loans pretty strongly relative to
13 GDP, which is the bright red line. They're all sort
14 of trending up strongly in lending.
15 So I think, by dollars, most of the loan
16 growth in this chart is coming from one-to-four
17 family, especially from commercial real estate, and
18 from C&I. Those are the big categories that banks
19 hold. And that'sthose are where most of the
20 dollars of growth are coming from.
21 Some of the notable smaller categories
22 that are growing very fast would be ADC or

1 construction lending, which is kind of rebounding
2 from its low. It kind of dipped sharply after the
3 crisis and now it's starting to come back. And
4 multi-family residential real estate is also again
5 a small category that's growing pretty fast.
6 And so the question that this kind of
7 growth raises is what kind of risks are banks taking
8 to achieve this growth? So some of our FDIC
9 publications in the last couple of years have
10 pointed out trends such as an increase in the
11 frequency of out-of-area lending. An increase in
12 the use of non-core funding by banks that have loan
13 concentrations in commercial real estate or
14 agriculture. So these are some of the signs that
15 we're seeing that, you know, there are some risks
16 being taken out there.
17 The big question is how these risk
18 behaviors are going to intersect with the external
19 environment. And in particular, the environment
20 for real estate. Because that's --, as I said,
21 that's what many community banks really specialize
22 in is real estate lending.

1 So turn to the last slide. So this
2 slide shows the inflation-adjusted price trends for
3 three types of real estate: agriculture, which is
4 the green line; commercial real estate, which is the
5 blue line; and; and one-to-four family, which is
6 the black line. And these are inflation- adjusted
7 in the sense that if these property prices were
8 tracking along with inflation, these would all be
9 horizontal lines at 100.
10 So you can see that agriculture, for
11 example, has really seen some significant price
12 appreciation since about 1990. --sort of a
13 long-term upward trend. Commercial real estate,
14 strong upward trend since the last recession --
15 since the end of the recession. And one-to-fours
16 are starting to show some pretty healthy price
17 appreciation since about 2012.
18 So you know, whenever you see these kind
19 of sustained price increases, you always get the
20 question of vulnerability to a correction. You
21 know, where are the vulnerabilities? And given the
22 importance of real estate loans to community banks,

1 you know, this clearly sort of just draws an
2 underline of the fact that prudent risk management
3 of those portfolios is very important.
4 Since I'm just the acting chief
5 economist, I'm not going to try to tell you where
6 the bubbles are. I was hoping I could throw it open
7 and, you know --
8 CHAIRMAN MCWILLIAMS: Could you tell us
9 where the acting bubbles are?
10 MR. FRENCH: So I thought we'd throw a
11 -- you know, a good place to stop. I'd be
12 interested in your comments on any or all of the
13 above. Deposit pricing, underwriting trends.
14 MEMBER TOLOMER: I think this is very
15 insightful. One of the things that I worry about
16 is when I look at the two-to-ten, it's now 27 basis
17 points. It looks to me like it's either going to
18 be a flat yield curve or worse, inverted
19 yieldinverted yield curve.
20 MR. FRENCH: Yes, that would be -- that
21 would not be a great development for income. It
22 would not.

1 MEMBER TOLOMER: But, I mean, it's been
2 falling. It was up 100 basis points -- – two-to-ten
3 was up twomore than 100 basis points not so long --
4 you know, a few months ago. And that portends what,
5 a recession, right? I know you're acting.
6 MR. FRENCH: Yes, it's traditionally
7 one of the warning signs of a recession. Of course
8 again, we've had a very long expansion going on nine
9 or ten years.
10 MEMBER TOLOMER: Right.
11 MR. FRENCH: But --
12 MEMBER SCULLY: In a low interest rate
13 environment --
14 MR. FRENCH: Yes.
15 MEMBER SCULLY: -- which changes so many
16 of the pressures on companies in particular. They
17 don't live in the same debt service pressure that
18 they would have.
19 MEMBER TOLOMER: Right.
20 MR. FRENCH: Do you have a lot of
21 variable rate borrowers or do you know of --
22 MEMBER SCULLY: Not as many as I'd like

1 to have --
2 (Laughter)
3 MEMBER TOLOMER: Well, we're asset-
4 sensitive and we do have a lot of line of credits
5 that's pegged to prime. But, like Mary Ann said,
6 not enough.
7 MEMBER SCULLY: So those low rates, I
8 mean, I think that's a huge part of the long recovery
9 is that, you know, companies haven't felt that
10 pressure from interest rates that they
11 traditionally have. And some of it's the interest
12 rates, and some of it's also that all of us have
13 fallen victim to -- a lot of those fixed rates
14 happened to keep them --
15 MEMBER TOLOMER: Well, and I think when
16 you speak to a customer about 5five-year money being
17 a 5.25, there's a real shock sticker shock that, you
18 know, 5 five what? You know, and it's going up
19 5.25, 5.50. Ten-year money is more expensive. So
20 there is a certain amount of our prospective
21 customers and customers certainly in my market
22 where when you start talking about 5 percent, you

1 know, they get palpitations. So it's going to be
2 an interesting thing with --
3 MR. FRENCH: Yes. You read a lot about
4 high leverage in the corporate sector, which is, you
5 know, the syndicated loans and all that.
6 MEMBER TOLOMER: Right.
7 MR. FRENCH: You know, which is sort of
8 a big bank issue. But, I mean, do you have any
9 concern about borrowers at sort of the smaller
10 business or mid-size being over leveraged or --
11 MEMBER TOLOMER: They've been more
12 optimistic and I think that they've been utilizing
13 the tax cut to fund some of their expansion. I
14 think some other people have had different
15 experiences. But in the New York metropolitan
16 area, we see loan demand. There's more refinance
17 opportunities in my estimation than business
18 expansion. Because I think a lot of the business
19 expansion is being funded by the tax cut. So --
20 MEMBER SCULLY: They're using
21 liquidity.
22 MEMBER TOLOMER: Exactly correct.

1 MEMBER SCULLY: They're all using more
2 liquidity. There's no rising tide. I mean, as
3 community banks, we all get to, you know,
4 arithmetically we can still grow just by taking
5 market share. We don't need a rising tide because
6 of our asset sizes.
7 MEMBER TOLOMER: Right.
8 MEMBER SCULLY: But it's a good thing
9 because there is no rising tide, I feel. They're
10 not -- you know, I don't think they're changing
11 their behavior --
12 MR. FRENCH: Loan demand, you're
13 saying, is not --
14 MEMBER SCULLY: It's refinancing.
15 MEMBER TOLOMER: Yes, I think there's
16 refinance and certainly in the New York
17 metropolitan area, the greater fool theory is
18 beginning to prevail. So multi-families are still
19 in some cases -- rates are below 4 four percent.
20 You know they've got to be doing that with magic or
21 pixie dust. Because it just doesn't add up to what
22 your cost is.

1 So there's that level, and a community
2 bank like ours wouldn't play in that arena because
3 it's just -- we can't afford to do that. But I think
4 -- and we have a fair amount of C&I business and we
5 see pockets of very successful businesses that are
6 looking to expand and have utilized their
7 liquidity. And some that are, you know, bumping
8 along better than they were, but not this vibrant
9 economy you see on CNBC or Squawk Box.
10 MEMBER WILLIAMS: That's interesting
11 because we are seeing that vibrant economy. We're
12 in the Salt Lake area. And loan demand, it's
13 liquidity and a deposit gathering result. We can
14 make as many loans as we want to. And it's market
15 driven. It's not necessarily competitive. All
16 the banks are doing well. It's kind of scary, it's
17 been going so well so long. But you know, if you
18 fly into town, all you see are cranes and continued
19 growth. And this is year 41 in the business for me,
20 and I'm beyond the nervous stage because they never
21 last this long, this good. So --
22 MEMBER BAER PAINE: We are seeing that

1 vibrant growth, as well.
2 MR. FRENCH: Where is your bank? I'm
3 sorry.
4 MEMBER BAER PAINE: Bemidji. Say it,
5 you can do it. Northern Minnesota.
6 MR. FRENCH: Oh, okay.
7 MEMBER BAER PAINE: Four hours north of
8 Minneapolis. So really in a rural area, but kind
9 of a regional center. But we are seeing that
10 continued growth and demand in both the housing and
11 the commercial.
12 MR. FRENCH: That's great.
13 MEMBER DONNELLY: I am from Kansas City
14 and we've started to see the effect. And we're not
15 at 5.25. We're at 6six percent. But that is
16 starting to deter borrowers and they're actually
17 not taking. There's plenty of demand but the
18 interest rate is starting to push -- We're getting
19 push back from borrowers and they're not taking on
20 debt. Which I think that's something the last
21 time, I don't think borrowers -- they didn't care
22 what the rate was. Before '08, they'd just give it

1 to you.
2 The borrowers now are maybe even better
3 borrowers -- we are just this last quarter. But of
4 course, also even at that rate, because of our
5 funding mechanism, it's the last bit of growth and
6 not making the same money. So there's no reason to
7 grow. Because the spread is so narrow, it's not
8 worth adding on unless you can get the loan spread
9 way up. But we've seen that effect, which really
10 surprised me. I thought maybe they'd go on a little
11 bit beyond 6 six percent. But this seems to be a
12 threshold that borrowers aren't willing to go over.
13 MR. FRENCH: Are depositors starting to
14 ask for, you know, where's my 25 basis points, or
15 whatever?
16 (Simultaneous speaking)
17 MEMBER WILLIAMS: For the last 60 days
18 --
19 MR. FRENCH: Okay.
20 MEMBER WILLIAMS: -- in our market,
21 we've seen movement.
22 MR. FRENCH: Okay.

1 MEMBER WILLIAMS: Pretty dramatic
2 movement actually.
3 MR. FRENCH: Interesting.
4 MR. MITCHELL: Have you seen people
5 actually -- if they don't -- if you're not meeting
6 their demands, people pulling deposits?
7 MEMBER WILLIAMS: Oh, absolutely.
8 MR. MITCHELL: Okay.
9 MEMBER BAER PAINE: They're shopping
10 for sure.
11 MEMBER DONNELLY: It's been a long time
12 since they were shopping.
13 MR. MITCHELL: Right, right. They've
14 been very slow, right, broadly speaking?
15 MEMBER WILLIAMS: We've been at a point
16 of indifference for years.
17 MR. MITCHELL: Right.
18 MEMBER WILLIAMS: And it appears that
19 we've busted through it. And, you know, we're in
20 a state, too, that's probably a huge percentage of
21 our market are credit unions. So that has a factor
22 on our pricing as well.

1 MR. MITCHELL: Sure.

2 MEMBER BAER PAINE: So, and that
3 affects us, as well. We have ten financial
4 institutions in our town and two are credit unions
5 in a town of 14,000. And what we have, there's a
6 lot of competition out there for both loans and
7 deposits. So you see some sub-prime lending and
8 you see some pretty big rates to get those deposits,
9 too. So you really have to manage your portfolio
10 on a regular basis.

11 MR. MITCHELL: Are you expecting -- so
12 the way I view it is it's greatly lagged. And now
13 are you anticipating there's a catch- up and then
14 plus then matching the next rate rise or --

15 MEMBER BAER PAINE: Yes. We've done
16 different things like five-year specials --

17 MR. MITCHELL: Okay.

18 MEMBER BAER PAINE: -- and put some
19 bigger rates out there. And just again kind of
20 managing your A customers. You're going to give
21 them the best rates that you can --

22 MR. MITCHELL: Sure.

1 MEMBER BAER PAINE: -- whenever you
2 can. But you have to deal with --
3 (Simultaneous speaking)
4 MEMBER TOLOMER: It only takes one or
5 two in the market. So you have somebody -- we were
6 at a function at the Fed and another CEO sat and he
7 said, "Boy you can't imagine what a 1.6 percent
8 money market does for your business." Well, sure
9 everybody else is at 80 or 90. So you know, then
10 it starts the whole chain of, well, what about CDs?
11 And so some of the larger banks need liquidity, as
12 do all of the banks. And so they raised their
13 rates, and then consumers are pretty bright. They
14 come in and say well "Well, if I can get that there,
15 why can't you help me here?" And so the game is on.
16 Now there's been six moves for the Fed
17 --
18 MR. MITCHELL: Right.
19 MEMBER TOLOMER: -- and we've probably
20 moved a couple of times. But there's no question,
21 there's pressure on deposit rates.
22 MEMBER WILLIAMS: We're seeing

1 something interesting, too, on the curves. You
2 know, basically we talked about a relatively flat
3 yield curve. The deposit curve in our market is --
4 it's up 250 basis points swaying over five years,
5 which is --
6 MEMBER SCULLY: But will anybody do the
7 five years?
8 MEMBER WILLIAMS: -- perplexing.
9 MEMBER SCULLY: What we're finding is
10 all the competitions between 13 and 26 or 27 months,
11 you can't get it -- We can't get a consumer to go
12 out longer than two years.
13 MEMBER WILLIAMS: Yes, we've lost some
14 to credit unions that are paying 3.25 five- year.
15 MEMBER MENON: I'm from the Las Vegas
16 marketVegas market, and what we're seeing primarily
17 is the local banks are pretty good in pricing the
18 supply. It's the Synchrony Bank. I don't know if
19 you guys see those ads all the time.
20 MEMBER BOEKA: Yes. We have the same
21 thing in southern California.
22 MEMBER MENON: In the local paper, you

1 know, which advertises significantly higher rates
2 than local banks are willing to pay. And obviously
3 the consumer looks at it and says, "Hey, this is what
4 I can get. Can you match it?" So we're seeing more
5 of that. But the Vegas market has been pretty
6 disciplined in its pricing standpoint.
7 But we also have a branch in Phoenix.
8 Now Phoenix is a very hot market from the standpoint
9 of gathering deposits. The rates are much higher
10 and a lot more banks competing for it. And so we
11 see an anomaly between Nevada and Arizona from that
12 standpoint.
13 MEMBER WILLIAMS: Interesting.
14 MEMBER TURNER: Have you analyzed this
15 property value slide -- the last slide you went
16 over, you know, as to what's going on? Is this a
17 result of NOIs being up? Is it a result of cap rates
18 coming down? Do you have a feel for what's going
19 on there?
20 MR. FRENCH: So I'll give you my
21 secondhand. I mean, the agriculture -- there was
22 a significant period of prosperity in agriculture

1 that probably came to an end about four years ago.
2 And there's been a sense a, you know a real stress
3 in the sector. But the land prices are still, I'm
4 told, holding up. They don't come open -- land
5 doesn't come open for sale very often. You know,
6 maybe once a generation, or even less, so the prices
7 are so far holding up.
8 The black line on 1 one-to 4- four is an
9 FHFA index of sort of repeat transactions from
10 across the country. So it's a pretty good sort of
11 widespread barometer of U.S. housing prices. Not
12 as sensitive as the Case-Shiller, for example.
13 MEMBER TURNER: Right.
14 MR. FRENCH: But, you know, my
15 understanding is the supply of housing is an issue
16 and sort of the prices are probably driven by --,
17 you know to some extent, by limited supply.
18 MEMBER TURNER: Right.
19 MR. FRENCH: And then this blue line is
20 an index of sort of institutional investors' total
21 returns on real estate. And it is what it is. I
22 can't say -- I mean I've heard certainly people say

1 cap rates are pretty low.
2 MEMBER TURNER: I think that's right.
3 I mean I think cap rates are low, you know, just on
4 a real basis. And I think they're probably fairly
5 low even when you -- you know as a spread to the
6 10-year Treasury or something.
7 MR. FRENCH: Right.
8 MEMBER TURNER: I think, you know
9 especially on certain types of property like
10 really, you know trophy multi-family property or
11 shopping centers in really big markets. It seems
12 like the cap rates are crazy low on that kind of
13 thing.
14 MR. MITCHELL: And we haven't
15 decomposed this slide into each of its components.
16 I think it would be very difficult. But there is
17 one part that I think you pointed out here. Is that
18 over this time period, we've been in a generally
19 downward trending interest rate environment with
20 some bumps up along the way.
21 But it's been, you know, a 30-, 40-year
22 long-term trend down that at least supported some

1 of this valuation increases. So there's a lot of
2 -- there's a lot at work here. I think this is
3 intended to really say there have been some
4 significant increases. Let's make sure we're
5 being really careful, you know, from an
6 underwriting perspective and aware that it can't go
7 on like this forever.
8 MR. FRENCH: Right.
9 MEMBER DONNELLY: If you don't mind
10 Patrick, go back to your slide, Number 5 -- Page 5,
11 the bottom loan and lease balance. And really
12 curiosity more so. I mean, the overall industry
13 trend in loan growth is slightly up.
14 MR. MITCHELLMITCHELL: Slightly.
15 Flattish to slightly up, right.
16 MEMBER DONNELLY: And then you show
17 pretty good growth in the community bank. But the
18 community bank probably size-wise doesn't make much
19 impact to the overall. So if you took the community
20 bank out, I mean, and leave the big banks in there,
21 have they moved at all in --
22 MR. MITCHELL: So let's just say, to

1 your point, if you remove the community bank out of
2 this, it really doesn't move materially because
3 it's still -- yes, I mean it moves it so little from
4 terms of weighted averages --
5 MEMBER DONNELLY: Yes. I figured
6 that's what it was. I just wanted to confirm it.
7 MR. MITCHELL: Yes, the rest of the
8 industry, I would say, has been essentially -- it's
9 been flat.
10 And, in fact, one of the things that
11 George noted here on his -- when he talked about loan
12 growth, -- you'll note that the one group that is
13 not in there is the 100-plus. So their loan growth
14 has actually been very flat and lower than GDP, at
15 least at the largest institutions.
16 MR. FRENCH: So this bottom- right of
17 Slide 5 is loans- to- assets. It's not loans. So,
18 loans- to- asset flat. It's different from loan
19 growth.
20 But, in any case -- yes, I think the
21 industry as a whole has been growing loans faster
22 than GDP. But certainly --

1 (Simultaneous speaking)
2 MR. MITCHELL: That's definitely --
3 (Simultaneous speaking)
4 MR. FRENCH: Certainly the smaller banks
5 are growing the fastest.
6 MR. DAVIS: Okay. With that, I'll try
7 and keep us on time again.
8 DIRECTOR GRUENBERG: Can I ask one
9 question before we go because it would --
10 MR. DAVIS: Sure.
11 DIRECTOR GRUENBERG: This has been a
12 terrific discussion. I really thank you. There
13 seems to be -- it's my perception and keen
14 sensitivity among you all that there really -- the
15 potential for inflation point in the economy is very
16 much on your minds. And a risk factor for you all
17 to pay close attention. At least, that's my
18 perception from the discussion today. Do you think
19 that's generally shared by your colleagues among
20 the community banks that they understand there are
21 vulnerabilities here? And that we have an
22 environment that may be shifting at some point?

1 MEMBER TOLOMER: I think it's -- yes.
2 I think the answer is yes, but I think it's expressed
3 differently. I think it's expressed in terms of
4 liquidity and cyber security as opposed to economic
5 pressures. I feel all three.
6 DIRECTOR GRUENBERG: Okay.
7 MEMBER TOLOMER: Okay? You know which
8 is the economy. When you see the two-to-ten, that
9 can't bode well. And you know, irrespective of
10 what you see on TV, that's my feeling. And I think
11 -- We we were talking about it at lunch -- cyber
12 security, you know, clearly is an issue. Liquidity
13 is an issue.
14 And I think the comments that Len made
15 about making loans, it is easier to make loans,
16 whether they're refis or they're expansion. But
17 the deposit base is more difficult and more
18 challenging. And I think that's an industry issue.
19 So I think there's greater sensitivity. It may not
20 be necessarily tied to economic pressures.
21 MEMBER TURNER: I think there is. And
22 I think that's something that the FDIC can do as you

1 examine banks, just as you -- you know, you have the
2 discussions. Just reinforce the fact that we're a
3 long way into an economic expansion. I think that
4 can be helpful.
5 MEMBER WILLIAMS: From a community bank
6 perspective, I think it's an interesting time from
7 the technology perspective as well. We're in a
8 market that has a lot of the ILCs, industrial,
9 industrial loan companies, that are deposit-
10 gatherers without brick and mortar. And seeing
11 what they're doing is pretty innovative.
12 And we're seeing the deposit loss.
13 We're not losing the customers. But in many cases,
14 we're losing depositors to the -- some of the
15 fintech type. But also the online big banks. I
16 mean Goldman is a great example. They've got a
17 whole different price model than we do. And when
18 people see that, now that we're past that inflection
19 point where there's interest -- no pun intended,
20 -- we're seeing some movement for the first time in
21 a long time.
22 And then you see some of the threats and

1 the discussions from the Apple-Amazon-
2 Facebook-Google world. I think there's a legit
3 threat out there to deliver the low cost from a
4 community bank. Kind of a high- cost- delivery
5 methodology to some of the alternatives that are
6 coming out there. So I think deposits aren't going
7 to get easier.
8 MEMBER KELLY: Martin, to speak to your
9 question. I think what I'm finding is, is kind of
10 disturbing in that I've heard this before about ten
11 years ago. And that, you know, not in my backyard.
12 You know, it's bad. Something's going to happen,
13 but not to us. So you see, that's what's gotten me
14 really concerned because they're continuing to go
15 headlong into multi-family, all this stuff that I
16 just think is overdone.
17 And at some point, you know, I think the
18 two-ten is something you do have to pay attention
19 to. Those are very smart people with lots of money.
20 And you know, the bet is that we're going to see some
21 inflation of some kind. And if so, then who's going
22 to get hurt?

1 But yes, from a community banking
2 perspective, I would say the folks that I've talked
3 to, they'll give me five minutes of that and then
4 55 minutes of why business has never been better.
5 You know, and the fact that they're going to build
6 a Taj Mahal or whatever. And I'm like, okay guys,
7 you know -- we're getting further -- I mean you guys
8 have been here. You all understand. You get
9 further from the fire, you forget the heat.
10 DIRECTOR GRUENBERG: Thank you.
11 MR. DAVIS: Thank you. Okay, for the
12 next panel, we're going to keep Diane and Matthew
13 Green will be joining us. Matthew's the associate
14 director of Financial Management and Reporting --
15 I'm sorry, Financial Management Reporting in the
16 Division of Insurance and Research. And Diane and
17 Matt are going to talk briefly about assessment
18 credits.
19 MS. ELLIS: All right. Thanks, Chad.
20 So this agenda item is here because David asked us
21 a question after we briefed our Board, I think in
22 the spring on the condition of the deposit insurance

1 fund balance. I appreciate the fact that David
2 keeps a close eye on our deposit insurance fund
3 balance and the reserve ratio. He always greets me
4 with the latest fund balance and reserve ratio.
5 And I'm appreciative of you.
6 Anyway, he thought, you know, Diane, I
7 really feel like we should talk about the assessment
8 credits that we --
9 MEMBER HANRAHAN: Typically because I
10 don't understand it.
11 MS. ELLIS: That's what this is for.
12 The assessment credits that we are I guess awarding
13 banks as we build up our reserve ratio from 1.15
14 percent to 1.35 percent. So I brought in Matt now
15 for reinforcements here. And he's going to
16 describe how that's going to work.
17 MR. GREEN: Sure. So before turning to
18 credits, I think it would be helpful to briefly
19 review the current outlook for the deposit
20 insurance fund. And some background information
21 on why community banks will receive credits.
22 So the deposit insurance fund balance stood

1 at 95.1 billion dollars on March 31st. That's a
2 10.1 billion increase over four quarters. The
3 reserve ratio, which is the fund balance as a
4 percent of estimated insured deposits was 1.3
5 percent on March 31st. And that's up from 1.2
6 percent in March of last year.
7 The FDIC staff expects that the reserve
8 ratio is likely to reach the statutory minimum of
9 1.35 percent in the third or fourth quarter of this
10 year. And that's two years ahead of the September
11 2020 deadline required by the Dodd-Frank Act.
12 After the deposit insurance fund surpassed 1.15
13 percent in the second quarter of 2016, regular
14 assessment rates declined, as called for under a
15 rule that the FDIC Board originally approved in
16 2010, and then reaffirmed in 2016.
17 When the lower rates went into effect in
18 the third quarter of 2016, quarterly assessments
19 paid by banks with less than 10 billion dollars in
20 assets declined on average by about one-third. The
21 Dodd-Frank Act requires, however, that banks with
22 total assets of 10 billion dollars or more, bear the

1 cost of the increase in the minimum reserve ratio
2 to 1.35 percent from the previous legal minimum of
3 1.15 percent.
4 So since the third quarter of 2016,
5 large banks have been paying temporary assessment
6 surcharges. In addition, small banks will receive
7 assessment credits for the portion of their
8 assessments that contributes to the increase in the
9 reserve ratio from 1.15 percent to 1.35 percent.
10 The final rule that we adopted in 2016
11 requires that we notify each small bank of the
12 amount of credits that it willwere received as soon
13 as practicable after the reserve ratio reaches 1.35
14 percent.
15 So, calculating the total amount of
16 credits will require information that will become
17 available only after we've reached 1.35 percent.
18 That information includes the amount of insured
19 deposits at that time, the total amount of
20 surcharges that large banks paid toward growing the
21 reserve ratio. , and the proportion of regular
22 assessments that were contributed by small banks.

1 So as I mentioned earlier, credits are
2 going to be assigned to small banks based on their
3 contribution to increasing the reserve ratio from
4 1.15 to 1.35 percent. So in developing the rule
5 that provided for credits, we had to make
6 assumptions about which funding sources would
7 increase the reserve ratio from 1.15 to 1.35
8 percent, as opposed to maintain the fund at 1.15
9 percent.
10 And the calculation in our rule assumes
11 that the fund's investment income, as well as any
12 reductions in losses from bank failures, will be
13 used for fund maintenance to maintain the fund at
14 1.15 percent. We assume assessment revenue is
15 needed for this purpose only to the extent that
16 other funding sources are insufficient.
17 So essentially this method attributes
18 reserve ratio growth to assessments as much as
19 possible, therefore maximizing the total amount of
20 credits that small banks will receive. And I would
21 add, we rarely get favorable comments on proposed
22 rules. And that was one of the rare instances where

1 we did.
2 So the total credit amount will also
3 depend on the quarter in which the reserve ratio
4 reaches 1.35 percent. We currently estimate that
5 the aggregate amount of small bank credits will be
6 between a half a billion dollars and one billion
7 dollars. The FDIC is going to allocate the credits
8 among small banks in proportion to each small bank's
9 average assessment base. Just roughly, it's total
10 liabilities during the time that the reserve ratio
11 was between 1.15 percent and 1.35 percent.
12 When the reserve ratio is at or above
13 1.38 percent, the FDIC will automatically apply
14 credits to reduce the small banks assessment up to
15 the entire amount of that assessment. And we
16 expect that, for most banks, credits will fully or
17 partly offset their deposit insurance assessments
18 for three or four quarters.
19 So with that, I'd be happy to answer any
20 more questions.
21 MS. ELLIS: It was hard to figure out
22 how much detail to talk about this issue. We tried

1 to strike the right balance, but tell us if we got
2 it wrong and we need to do any follow-up here.
3 MEMBER HANRAHAN: Well, your last
4 comment was the punch line. You expect it to --
5 MS. ELLIS: Yes.
6 MEMBER HANRAHAN: -- party or fully
7 cover three to four quarters.
8 MS. ELLIS: That's right.
9 MEMBER HANRAHAN: That's a lot.
10 MS. ELLIS: Yes.
11 MEMBER WILLIAMS: Define small banks
12 for this purpose.
13 MR. GREEN: Generally banks with 10
14 billion or less in assets.
15 MS. ELLIS: All right. Hey, there you
16 go. Happy news. So as a follow-up, I do
17 understand that at the end of the session right
18 before lunch, some questions came up about the small
19 bank pricing methodology and assessment appeals, so
20 forth.
21 If it makes sense, we'd be happy to come
22 back at the next meeting that we have, which is just

1 going to be in three months and talk about the small
2 bank pricing methodology. It's been in place, you
3 know for a couple of years now. We can talk about,
4 you know, what it is and what some of the effects
5 are. And maybe that would answer some questions.
6 And would be happy to answer any other questions now
7 or offline.
8 MEMBER SCULLY: I think it would be
9 great if you came back and did that. Because I know
10 recently we've just gone through an acquisition,
11 and so we're taking a look at our much larger
12 assessment and trying to figure out the components.
13 And, you know, it came back to the asset mix being
14 --
15 MS. ELLIS: Yes.
16 MEMBER SCULLY: -- more of the weight
17 than our CAMELS rating. So I'd just be interested
18 in like how typical that is, or atypical that is.
19 MS. ELLIS: Okay, sure. Yes. That
20 would be easy. We would be happy to do something
21 like that. Okay?
22 MR. DAVIS: Okay.

1 MS. ELLIS: Good.

2 MR. DAVIS: Okay, we have a break on the

3 agenda next. We will resume again at 2:45 and hear

4 from the Ombudsman at that point. So thank you.

5 (Whereupon, the above-entitled matter went off the record at 2:28 p.m.

6 and resumed at 2:42 p.m.)

7 CHAIRMAN MCWILLIAMS: All right, so

8 we're back for the Ombudsman update. And I

9 understand it's been a while since you have had an

10 update from the Office of the Ombudsman. And what

11 I would like to do unless, you know, I hear otherwise

12 is to basically include an update from the Ombudsman

13 at every meeting. Because we're trying to make

14 this process of what the Ombudsman does and the

15 function as robust as possible. And your feedback

16 would be very welcome in that process. Unless you

17 think there's a better way to use up 15 or 20

18 minutes, you know, I'll make sure that we have the

19 Ombudsman update at every meeting.

20 All right, I like when nobody disagrees.

21 That's good. Go ahead.

22 MR. LOWE: Do I get a vote?

1 (Laughter.)

2 CHAIRMAN MCWILLIAMS: No, that was not

3 an option.

4 MR. DAVIS: Okay. Anthony Lowe is the

5 Ombudsman. And I will not add to those remarks

6 anymore, and just turn it over to you.

7 MR. LOWE: Okay. Thank you, Chad.

8 Good afternoon, everyone. I want to just talk with

9 you briefly this afternoon about the Office of the

10 Ombudsman here at FDIC. Talk a little bit about our

11 operations. Where we get the majority of our

12 information, how we do reporting up the line to the

13 Chairman's Office, and some of our objectives that

14 we have set forward for 2018. And some of them will

15 carry over into 2019.

16 Just for a little bit of historical

17 perspective, the Ombudsman Office was established

18 in accordance with the RiegleRiegle Community

19 Development and Regulatory Improvement Act back in

20 1994. , which required all of the bank financial

21 regulatory agencies to establish a liaison that was

22 independent of the main operations of the offices

1 that could serve to listen to issues, concerns, --
2 whatever the case might be -- that pertain to the
3 regulated entity. If they had concerns about the
4 operations, about, you know, the oversight, they
5 could bring those questions, those concerns to the
6 FDIC.
7 When you think about a definitional
8 standpoint, if you go to the second slide, it pretty
9 much gives you the major tenets of an ombudsman
10 office. And these have been established by the
11 Administrative Conference of the U.S., which
12 established guidelines for ombudsman standards.
13 And the major tenets that we have here
14 are that we're independent. We're neutral. We're
15 confidential and we're informal. And just to give
16 you a little bit of perspective on each of those from
17 an independence standpoint, my office reports
18 directly to the Chairman's Office. We do have
19 periodic discussions with some of the division
20 directors and other parties here at FDIC. But from
21 a reporting standpoint, we do report directly to the
22 Chairman's Office.

1 We're neutral in that we do not advocate
2 for the FDIC or any of the stakeholders. -- that
3 being banks, trade associations. Whoever brings a
4 matter before us, we advocate for a fair process.
5 We're confidential. That means any of
6 the matters that are brought to our attention by the
7 stakeholders, we do keep it confidential unless the
8 stakeholder has given us the authority to discuss
9 their individual matters or their individual names.
10 The majority of the reports that we produce, we do
11 not indicate bank names because we do want to
12 maintain that confidentiality. Again, unless it
13 is a unique matter that we think we do need to take
14 it further and we do need to do some additional
15 review. And we do get the concurrence of the party
16 that's bringing it before us to do so.
17 And we're informal. We try to find a
18 collaborative resolution to any issues or problems
19 or concerns that have been brought before us. We
20 do not get involved in the formal appeals process
21 at this particular point in time. We do not have
22 the authority to change regulations, to change

1 statutes, or to change decisions. So again, we do
2 operate in an informal basis at this time, and try
3 to resolve issues at the lowest level. And at the
4 most soon possible -- as soon as possible as it's
5 brought before us.
6 When we talk about the role of the
7 Ombudsman, if you go to the third slide. A big part
8 of that is just providing an FDIC perspective to the
9 stakeholders. And when I say stakeholders, I'm
10 talking about bankers, the public, trade
11 associations, and also other regulatory
12 authorities.
13 As I mentioned, a big part of what we do
14 is providing feedback to the Chairman's Office.
15 We're always on the lookout for any potentially
16 systemic issues. And when I mention systemic,
17 those are issues that, from my office standpoint,
18 we continue to see issues that come up almost
19 routinely on a daily basis when my staff is out
20 visiting with banks. Or, that we've indicated that
21 a majority of the banks or we think a majority of
22 the banks have some level of confusion with regard

1 to what it is the agency is requesting or what the
2 expectations are. So we're always on the lookout
3 for potential systemics.
4 We do work with other divisions to
5 address issues that might be raised. , and
6 encourage improved policies and practices. And we
7 do help to facilitate or try to help facilitate
8 effective communications between the agency and
9 stakeholders. And again, the majority of those are
10 banks.
11 I think one of the major tools that we
12 have in our toolbox is being able to facilitate
13 communications between the right people at the bank
14 with the right people at the right level at the FDIC
15 to get issues resolved. So that's a major tenet of
16 my office.
17 If you look on Page 4 or Slide 4, it gives
18 kind of a brief overview of our org. chart with me
19 as the director. I have an associate director
20 position that will be filled soon. I have regional
21 ombudsmen, -- six of them. -- one in each of our
22 regions around the country. And here in

1 Washington, I do have a small staff of senior
2 ombudsman specialists.
3 Just for a little context, the regional
4 ombudsmen, on a daily basis for the most part, are
5 visiting banks around the country. On average on
6 an aggregate basis, we usually touch base with
7 somewhere between 500 to 600 banks each year that
8 we're on site. And that's outside of cases that may
9 come to our attention because banks have called us
10 and asked us to review or investigate a matter. So
11 those folks are constantly out gathering
12 information that we do put into reports
13 periodically that do go to the Chairman's Office.
14 The senior ombudsman specialists here
15 in Washington, again a small group, but they do
16 handle all of the incoming mail, the email, phone
17 calls. And we've been averaging for the last five
18 or six years, about 2,000 inputs on an annual basis.
19 And I'll talk a little bit more about what some of
20 those calls are. And you know, what we eventually
21 do with those. So a pretty busy office, you know,
22 and a lot of inputs that come from a lot of different

1 groups around the country.
2 If you look at Slide Number 5, it does
3 give you some information about the groups that are
4 contacting our office. And, of course, as you see
5 here, close to 90 percent of the contacts do come
6 from the public. A little bit of a dichotomy, the
7 largest number of contacts do come from the public.
8 But the majority of our time is spent on issues that
9 are presented and cases that are presented by banks.
10 Some of these cases that do come from the
11 public, some of them are very simple. People are
12 asking about FOIA, they're asking about getting
13 some records released. We oftentimes do get, you
14 know, calls from individuals that had a loan maybe
15 at a bank that has failed. They want to find out
16 where they can get a title or get some information
17 with regard to an estate that they need to settle.
18 And sometimes individuals do see us a
19 last resort because they've gone through the civil
20 actions. They have a dispute with a bank about a
21 deposit or something that they think they've not
22 been treated fairly. And they do contact our

1 office to see if there's any avenue or strategy that
2 we can assist them with. And again, we do get about
3 2,000 of those on an annual basis.
4 The method of contact that we have for
5 the most part is telephonically. Now, when you
6 look at this chart on Tab Number 6, you know, I think
7 I have to explain that there's a little bit of a
8 waterfall effect. The majority of the cases do
9 originate from a written -- I mean to say a written
10 contact. After we get that -- I'm sorry, a
11 telephonic contact. After we get that initial
12 telephonic contact, oftentimes, the next step will
13 be a written letter that will request some
14 additional information. And then at the end of the
15 day, oftentimes we do have a sit- down or a
16 face-to-face meeting with the banks or the
17 individuals that have brought the matter to our
18 attention.
19 We do work with the other divisions
20 around the agency, including RMS and DCP. , again,
21 to try and identify potential issues or concerns,
22 and trying to facilitate better practices and

1 policies. , and also to make sure that we can
2 clearly articulate what our expectations are from
3 a regulatory standpoint.
4 We do participate also with the Division
5 of Resolutions on bank closings. And
6 specifically, we do participate in putting together
7 a Q-and-A guide as provided for closings. , and
8 also assist with having discussions with bank
9 customers after the bank closes. We also, from time
10 to time, will participate with our communications
11 group on putting together press releases. , and if
12 needed, participating on some local media
13 participation.
14 A couple other items that I did not put
15 in the package here that we do participate on.
16 Anytime that we do have a formal appeal that comes
17 to the FDIC, after it's settled and gone through the
18 SARC process, within 180 days after that is
19 completed, whatever the decision is, we do go visit
20 that institution. just to have a discussion with
21 them about the process. -- if they have any
22 suggestions for improvement. -- if they feel like

1 they were treated fairly. And then again, we do
2 report that information up to the Chairman.
3 We also do visit with institutions that
4 have converted either to the FDIC as their primary
5 regulator or away from the FDIC. And we usually do
6 that within 90 days after that information becomes
7 available to us. Because we do want to know, you
8 know, what was the mechanism? What was the trigger
9 that made you want to either come to FDIC or to leave
10 FDIC. ? And the majority of the time, those that
11 do come to FDIC, it's because of cost and budgeting.
12 They usually will tell us if they were a Fed member
13 or national bank that the cost for operating from
14 a regulatory standpoint is going to be a little bit
15 less with FDIC.
16 They also often tell us the majority of
17 the time that FDIC has local examiners that know the
18 local market. , and the majority of the bankers
19 really do appreciate them.
20 I think I skipped one slide. This one's
21 very -- eExcuse me -- very important. Slide Number
22 7 talks about frequently- reported areas of

1 concern. Approximately 60 percent of the items or
2 the matters that do come before our office are in
3 regard to the examination process. Some of them
4 are fairly simple. They call and ask why is the
5 examination taking so long? You know, why can't I
6 get closure with regard to an application that I
7 have outstanding? A lack of response, you know,
8 from one of the offices with regards to some
9 correspondence. So again, about 60 percent of the
10 calls or the cases are in regard to that.
11 We also get about 23 percent or 22
12 percent of our calls and cases in regard to the
13 banking environment. This is usually cases with
14 regard to the bank saying there's unfair
15 competition. They often raise issues with regard
16 to credit unions, farm credit, those type of things.
17 And they also raise issues with regard to
18 regulateregregulatereg burden and Call Reports.
19 Those type of things. And the other two are
20 regulatory matters and banking legislation make up
21 the balance there.
22 For 2018, some of our major goals that

1 we've set for the office are to broaden industry
2 awareness of the Ombudsman. And make sure that the
3 industry, including individual banks and the trade
4 associations, know what our office can do. Know
5 what services that we can provide. And again,
6 monitoring the feedback that we get from community
7 bankers, -- I think it's extremely important.
8 Again, we're going to be looking for
9 systemic issues and things that we might need to
10 look and see if we can independently or do need to
11 independently change any of our policies or our
12 processes with regard to supervision of community
13 banks.
14 And we're also in the process of
15 developing a pilot program to start external
16 reporting on our activities on an annual basis.
17 Hopefully, to give some information, you know, from
18 a transparency standpoint about the number of
19 outreach events we've had, the number of contacts,
20 what the contacts have been in regard to, and some
21 trend analysis.
22 And each of you should have at your seat,

1 some contact information about the office. My
2 business card has my direct phone number. And you
3 know, definitely, I hope you will spread the word
4 about the Ombudsman Office and the services that we
5 can provide.
6 And I'll take any questions that you
7 might have.
8 MEMBER HANRAHAN: Anthony, can I ask
9 you a couple of questions about Slide 5, -- that
10 pie chart?
11 MR. LOWE: You told me you weren't going
12 to ask any questions.
13 MEMBER HANRAHAN: I said what you
14 requested was easy ones, and I'll try and do that.
15 MR. LOWE: Okay.
16 MEMBER HANRAHAN: First a comment.
17 I'm astounded that the vast majority of your
18 contacts are from the public. I never would have
19 guessed that. Doing some math, though, on the
20 percentages, I think you said you have 2,000-ish
21 points of contact inbound a year. So if 13 percent
22 of those are from the industry, that means there's

1 260 or so from bankers. Are those 260 unique
2 matters or -- because that seems actually like a lot
3 to me -- or could those be multiple points of contact
4 on one matter?
5 MR. LOWE: Yes, good question. Some of
6 those will be multiple issues that bankers will
7 bring forward to us. Oftentimes, though, when they
8 make the initial contact with us, it will be one
9 issue. It may be, you know, I'm not sure how the
10 FDIC arrived at this, you know, particular rating.
11 Can you help me look at the definition? And when
12 we make the callback or have further discussion with
13 them, they will often bring up another issue.
14 Well, you know last year, my numbers were here.
15 They're the same this year, and I'm not
16 understanding the metrics as to why there was a
17 downgrade or a change in the supervisory strategy.
18 So some of these, you know, there would be some
19 waterfalls there.
20 MEMBER HANRAHAN: Thank you.
21 MR. LOWE: Yes.
22 MEMBER SCULLY: So I think it's a

1 wonderful assistance to everybody to know that
2 you're there. But I've always been curious about
3 how do you resolve from a process standpoint? You
4 know, handling a transaction, handling a
5 communication, the inherent conflict between
6 confidentiality, and closure of the issue?
7 Somebody's complained to you, . How do you resolve
8 that? I mean, if it's just an informational
9 question -- but if it's actually a complaint, how
10 do you resolve that and maintain confidentiality?
11 MR. LOWE: You know oftentimes, again
12 because my regional folks are out on a daily basis
13 and I do get weekly reports. And oftentimes,
14 they'll have similar issues that have been brought
15 forward. You know, if there's a new FIL that has
16 been issued and there's some concerns about clarity
17 as to again, what the expectations are, when I do
18 meet with the division directors of RMS or DCP our
19 or Resolutions if the case, you know, dictates that.
20 I will just present hey, I've been getting
21 consistent questions, consistent you know concerns
22 about this particular issue from A to Z. and try,

1 again, to mask the identity of the individual
2 institution.
3 Sometimes we do get cases that come in
4 that we do have to tell the bank that we cannot
5 resolve that without releasing information, e.
6 Especially those in regard to applications that
7 they think have been, you know, been sitting for too
8 long, or they can't get a response as to why it
9 hasn't been resolved.
10 MEMBER SCULLY: Okay.
11 CHAIRMAN MCWILLIAMS: Anthony, it may
12 be helpful if you walk us through the mechanics of,
13 say, a bank calls up and says somebody from the bank
14 says, you know, we just had an exam and we believe
15 the examiner is going to retaliate against us.
16 What do you do from there?
17 MR. LOWE: Yes, when we have a case that
18 comes in and that does occur. I won't say it's
19 often, but we do have that occur from time to time.
20 Usually we'll try to get some additional, more
21 granular information from that individual, the
22 banker. You know, sometimes we will ask one of our

1 regional folks to go out and visit with that
2 individual bank. , and, you know, try and get some
3 more information. Is there something tangible
4 that you can show us that clearly, you know, shows
5 that there was, you know, potentially intimidation,
6 or why you would be intimidated.?
7 And then usually we'll get into the
8 records of that particular bank and try and see if
9 there's anything in the written record that appears
10 to be inappropriate or that may be outside of
11 policy. And eventually we will usually have a
12 discussion with the division managers if it's risk
13 management, you know, with Doreen Eberley and her
14 staff. , or if it's on the compliance side, with Mark
15 Pearce and his staff. So it is a, you know,
16 gradual step- by- step process that we go through.
17 Again, not advocating, and we don't immediately say
18 that either side is right or wrong. But any case,
19 especially like that, that we get, we do take it
20 seriously from the beginning, and we set up a
21 strategy to see how we can determine has there been
22 an issue here? Has there been, you know, why does

1 the bank feel intimidated?

2 One thing also that when my regional

3 folks go out on a daily basis and when I do visit

4 with trades, I always make sure and talk to them

5 about the examination surveys. I tell them, this

6 is a good way to do feedback to the FDIC. You know

7 if you had an issue with regard to the

8 professionalism or that, you know, some matters

9 were not clearly explained to you during the course

10 of the examination, use that survey.

11 But, also, we always tell them, the best

12 source for you to try and resolve issues is to talk

13 with the examination personnel, you know, at the

14 local level. The majority of the time -- often

15 times we do find it's just a matter of, you know,

16 two ships passing in the night. And not really

17 listening to each other. But when we put the two

18 together, usually they can resolve the matter

19 amicably. They may still disagree, but they can at

20 least get it resolved.

21 CHAIRMAN MCWILLIAMS: And on your Page

22 7, looking at the frequently- reported areas of

1 concern. Can you give us the numbers? What sample
2 size is this based on?
3 MR. LOWE: This is from 2017. And I did
4 not bring the exact numbers in with me, but I can
5 get that. I can get it to you and distribute to
6 everybody.
7 MEMBER DONNELLY: Do you have, you
8 know, without names of the resolutions, you know,
9 how do they end up a 57 percent were examination
10 issues? Do they trend generally that the bankers
11 were wrong, or do they trend -- I'm trying to find
12 out.
13 MR. LOWE: I'm not going to say that in
14 here.
15 MEMBER DONNELLY: I threw it out that
16 way because I didn't want to throw it the other way.
17 CHAIRMAN MCWILLIAMS: It's only his
18 first meeting.
19 MEMBER DONNELLY: Do you see that it's
20 -- you said it was just a matter of communication.
21 MR. LOWE: A big part of it's often, you
22 know, just communication. It could be a case where

1 the examiner did not fully again articulate how they
2 arrived at a conclusion. Oftentimes, you know we
3 will just crack open the manual of examination
4 policies. Send that information. Send the
5 definitions for some of the components. And some
6 of the items that we look at, for instance, under
7 the management component. And after we have that
8 discussion, the banker will come back and say, "Oh,
9 I completely understand." Again, they may say they
10 still disagree, but often times it's just, you know,
11 providing that information.
12 Also sometimes, you know, we do have
13 bankers that, you know, do just want to have a
14 discussion at a higher level from, you know, the
15 field level examiners. You know, often -- I know
16 one of the bankers earlier mentioned about going up
17 on every six months and visiting at the regional
18 office. And that's something that we often will
19 advocate for banks to make sure that you know who
20 your primary points of contacts are. Have those,
21 you know, kind of in your speed dial.
22 If you have a question at any point in time,

1 you know, you should never been inhibited or
2 intimidated from making a call. If there's
3 something you don't understand in the examination
4 process or the regulatory oversight process, you
5 know a banker should never feel intimidated to make
6 a call, ask a question, and make sure they get an
7 answer that they clearly understand.
8 CHAIRMAN MCWILLIAMS: And so, do people
9 understand the process? And I don't mean to put
10 either Mark or Doreen on the spot, but I might just
11 now. If a bank, say, allows you to say okay, fine.
12 You know, you can give the division director our
13 name and we believe this is not going to get
14 resolved. Then you go to Doreen or Mark and you
15 tell them oh, there's an issue. Here's the bank and
16 then what happens then?
17 MR. LOWE: Yes, I will either go to Mark
18 or Doreen, or if it has not -- if there's no need
19 to elevate it to that level, -- one of the regional
20 folks may talk with one of the regional directors
21 and say hey, this bank or their attorney has called
22 several times. They cannot get a response with

1 regard to this issue, you know, why this rating, you
2 know, came out as it was. The bank had some
3 additional information they wanted to share before
4 the exam was completed. Or again, it could be the
5 application.
6 So at some point, either the regional
7 ombudsman will talk with the regional director, or
8 I'll have a discussion with either Mark or with
9 Doreen and see if we can, you know, find out what
10 the facts are with regard to the case.
11 CHAIRMAN MCWILLIAMS: Does either one
12 of you have anything to add before Chad cuts me off?
13 All right, thank you.
14 MR. LOWE: Thank you.
15 MR. DAVIS: I allowed four minutes for
16 Cchairman's prerogative. Thank you, Anthony.
17 The next panel will provide a -- will
18 brief the committee on a forum that the FDIC held
19 on May 7th about the use of technology in the
20 business of banking. Doreen Eberley, the
21 Ddirector of the Division of --
22 CHAIRMAN MCWILLIAMS: Thank you.

1 MR. DAVIS: -- Risk Management
2 Supervision will provide an overview of the panel
3 discussion on emerging technologies that are
4 transforming banking operations.
5 Mark Pearce, Ddirector of the Division
6 of Depositor and Consumer Protection, will
7 highlight the panel discussion on the impact of
8 emerging technologies on retail banking, including
9 new and innovative delivery channels, enhanced
10 customer experiences, and economic inclusion.
11 And Jonathan Miller is back and will
12 provide a summary on the panel discussion about data
13 access and balancing rights and security.
14 MS. EBERLEY: Okay, great. Maybe
15 before we move into the forum panel topics, I'd like
16 to share just a little bit of the work we've been
17 doing at the FDIC to ensure that we're prepared to
18 understand and address the changing landscape in
19 financial services, and the way banks use and adapt
20 to new technologiesIn in our roles as bank
21 supervisor, deposit insurer, and receiver of failed
22 institutions. This is something that we really

1 have dedicated significant resources to over the
2 last few years.
3 To lead these efforts, the FDIC has
4 established an emerging technology steering
5 committee that's co-chaired by myself and Mark
6 Pearce. The other members of our steering
7 committee include the most senior members of our
8 organization, including our chief information
9 officer and chief privacy officer, our general
10 counsel, and the directors of the Division of
11 Resolutions and Receiverships, Division of
12 Insurance and Research, and Office of Complex
13 Financial Institutions.
14 And then our steering committee, in
15 turn, has established two inter-divisional working
16 groups that consider the retail and wholesale
17 aspects of emerging technologies in banking.
18 Through these efforts, we're monitoring trends,
19 opportunities, and risks in this area. , and
20 evaluating impacts on banking, general safety and
21 soundness to deposit insurance, financial
22 reporting, economic inclusion, and consumer

1 protection.
2 And then this work informs our
3 supervisory strategy for responding to
4 opportunities and risks presented by the use of
5 emerging technologies to supervised institutions.
6 And it really is this backdrop that led us to
7 determine to host the forum back on May 7th.
8 So the forum included three panels.
9 Each one of us moderated one of the panels. , and
10 I'll go ahead and kick off, as we spend the next few
11 minutes describing the discussion that took place.
12 The first panel focused on how emerging
13 technologies are transforming banking operations
14 and back office functions. , so, the so-called
15 plumbing of the financial system. The panel
16 discussed how banks can establish a strategy to
17 support implementation of emerging technologies.
18 And importantly, ways to ensure that security is
19 built into the innovation as it's being developed.
20 The panel also discussed how banking
21 operations can be transformed by technology such as
22 distributed ledger technology applications and new

1 payment infrastructures. And then finally, the
2 panel discussed how innovations in automation,
3 pattern recognition, and cognitive computing are
4 being implemented to improve operational
5 efficiency.
6 The panelists included John Macaluso
7 who is Senior Vice President of Business
8 Development with Fiserv. ; Steve Ledford, Senior
9 Vice President with The Clearing House.; Shaida
10 Lynch, Vice President of Business Technology -
11 Banking and Lending in support of the consumer
12 banking organization for Discover. ; Dr.
13 Victoria Adams, principal of U.S. Ggovernment
14 programs at ConsenSys. ; and John Doherty who is
15 a partner in Ernst & Young's integrated cyber risk
16 management practice.
17 So, John Macaluso kicked us off, and he
18 discussed strategies that support the entire
19 digital experience that's required for banks to
20 move forward in delivering good customer
21 experiences. The takeaway from his presentation
22 was that he encouraged banks to adopt a digital

1 mindset focused on demonstrating to customers that
2 you get them. , offering immediate availability of
3 funds and services. , and creating these offerings
4 in an inspiring package,, making it exciting.
5 There was some discussion about whether it was good
6 to be boring as banks or exciting as banks. He
7 opted for exciting.
8 Steve Ledford provided an overview of
9 the real- time payments platform, which is the first
10 new core payments infrastructure in the U.S. in more
11 than 40 years. He spoke of the benefits of a credit
12 push system to minimize fraud. , and described how
13 The Clearing House wanted the real- time payments
14 platform to really be the plumbing of the industry,
15 and a safe foundation upon which everyone else could
16 innovate.
17 Shaida Lynch shared examples of using
18 technology to transform banking operations. She
19 started with a prediction from Gartner that by 2020,
20 consumers will manage 85 percent of their business
21 relationships without interacting with humans. ,
22 and she talked about what that meant for

1 institutions. -- that banks will need to find new
2 ways to interact with their customers without
3 talking to them or seeing them, using things like
4 Business Chat. And she also spoke of the use of
5 technology to automate backroom operations to speed
6 customer services and the use of cognitive
7 computing for fraud detection and prevention.
8 Victoria Adams, (Tori) spoke of how
9 blockchain was first seen as something exciting and
10 new that would disrupt banking. , but now is seen
11 more as a product that the industry wants to adopt
12 to improve its operations. The challenges of
13 adoption that she discussed included the need for
14 any kind of a blockchain to interact with legacy
15 systems at on and off ramps to the chain.
16 , so she predicts that any wider adoption will
17 have to be part of a larger digital transformation
18 of the industry. And she opined that we're in the
19 midst of really a significant period of
20 transformation. And she closed with the
21 observation that, as a rule, we over-predict the
22 technological advances that will occur in a

1 one-year time horizon, but really grossly
2 under-predict what will happen in a ten-year
3 horizon because we just can't imagine the
4 transformations that will take place over that
5 timeframe.
6 And then our last panelist, John
7 Doherty, discussed the need to ensure that security
8 is built in as the innovation is being developed.
9 He quoted a Forrester report that stated 44 percent
10 of individuals polled don't like conducting
11 business in an online environment because they
12 worry about security, and that 74 percent would
13 leave a company if they experienced a breach.
14 He agreed with Tori that we're in the
15 midst of a significant period of technological
16 change. , and that the industry is going to look
17 a lot different ten years from now.
18 In determining when to implement new
19 technology, you know, are you an early adopter or
20 a follower? The panelists spoke about the
21 importance of focusing on the problem it was
22 solving. -- not to adopt new technology just to

1 recreate or mimic an existing process, but really
2 to solve an unsolved problem.
3 They also agreed that the focus of new
4 technology adoption, right now anyhow, was focused
5 on improving the customer experience, as opposed to
6 achieving cost savings. Those institutions that
7 were using it were really using it for the former
8 purpose.
9 In terms of distributed ledger
10 technology, Tori offered that a meaningful- use
11 case will be one that starts with a problem for which
12 distributed ledger technology may be helpful. , as
13 opposed to just a desire to use this technology to
14 mirror an existing process on a distributed ledger.
15 The example she gave was, you know,
16 somebody coming to her company and saying, you know
17 , "I can get funding if I do this on distributed
18 ledger technology. , so I want to use this
19 technology to fix my problem. ," as opposed to
20 coming and saying , "I have a problem to solve. ,
21 you know, I'm looking for ways to fix this
22 particular issue. I think distributed ledger

1 technology might be a piece of the puzzle."
2 And then, finally, the panelists agreed
3 that technological advances were more likely to be
4 transformational to the industry as opposed to
5 revolutionary, but this was going to take time.
6 Banks will take a practical approach to
7 incrementally meeting the needs and desires of
8 customers and conducting business in real time.
9 So it really was a great panel. I'd
10 encourage you to take a look. You can watch any of
11 the panels or the entire daylong event on Video on
12 Demand on our website under Nnews and Eevents.
13 MR. PEARCE: And for the first panel,
14 even though everyone said they talked about banking
15 being boring, it was actually really a --
16 MS. EBERLEY: It was a very entertaining
17 panel.
18 MR. PEARCE: -- dynamic and entertaining
19 panel, especially on a topic of plumbing. So my
20 panel was related to the interaction of banks with
21 their customers. -- so more retail- focused and
22 really looking at the potential benefits of

1 emerging technologies as they bring to banking and
2 to their customers, while considering potential
3 challenges and risks of implementing new
4 technologies.
5 So the panelists -- we had five
6 panelists; Steven Antonakes who works at Eastern
7 Bank in Massachusetts. It's an $11 billion bank.
8 And Steve talked about creating an innovation lab
9 in the bank. They had actually acquired a firm,
10 brought it into the bank, and then used that group
11 of people to essentially digitize their application
12 process for small business loans.
13 They had seen some of the customers and
14 other people in the marketplace going to online
15 small business lenders, and they thought that they
16 could bring their underwriting and they had a good
17 ability to review loans. But providing that fast-
18 and- easy application process was something that
19 they were missing. , and so they used this
20 innovation lab to digitize their process and expand
21 their lending activity.
22 They then had so much success with that

1 and that company, then they've spun that company
2 off. And now that company serves other banks to
3 digitize some of their small business lending
4 activity. And they have gone to what they called
5 a Lab 2.0 where they're now growing a new innovation
6 lab in their bank with homegrown employees. And so
7 they've really invested a lot of time and energy in
8 the technology side.
9 Todd Nagel who's the President and CEO
10 of River Valley Bank, which is a $2 billion dollar
11 bank in Wisconsin, he talked about challenges in his
12 marketplace generating core deposits. And so they
13 came up with an idea of having an online bank
14 entirely online. , and be able to gather deposits
15 from a much larger geographic area. So they
16 created a bank and they branded it Incredible Bank.
17 This was before Incredibles 2 came out, so I don't
18 think there was a trademark, copyright issue there.
19 But has had great success there.
20 And he really described that as bringing
21 some of the benefits of a community bank, -- the
22 high-touch nature -- but using technology to

1 leverage that. and provide the same type of
2 service, but use the technology to solve those
3 problems and make it feel high- touch. He talked
4 about their ability to do all of their closings that
5 they do for some of their lending products. They
6 can do all the closings electronically. , and so
7 the people don't have to come into the bank or send
8 things through the mail to close the loan. And so
9 we sort of thought that as really enhancing their
10 relationship with their customers.
11 Jonathan Prendergast who is the head of
12 the Payments Strategy Group for TD Bank talked about
13 their bank's efforts to use technology to provide
14 a seamless experience, no matter how their
15 customers wanted to interact with them. So whether
16 they wanted to come into the branch, whether they
17 wanted to call on the phone, or go online, or use
18 a mobile application, they talked about how they
19 wanted to integrate all of that. So that no matter
20 how their customer wanted to interact with them,
21 they would be able to do as many capabilities,
22 regardless of the channel. Discussed that being on

1 the channel.
2 He also talked a little bit about being
3 an early adopter of Zelle peer-to-peer payments
4 application because he really saw that as helping
5 solve a challenge that his customers had with moving
6 money around.
7 Ravi Loganathan, who is from Early
8 Warning, was there really to just talk about Zelle
9 and the development of Zelle. And, I think, one of
10 the interesting things that he brought forward was
11 that banks have the ability to customize the
12 application in their use of Zelle so that it would
13 have the same type of marketing and branding of the
14 bank that was utilizing it. so that community
15 banks and others could tailor it to make it feel like
16 it was part of that banking, and consistent with the
17 bank's other marketing and branding.
18 And then, finally, Patrick Smith from
19 KeyBank in Ohio talked about how using technology
20 and data together enabled them to provide insights
21 that help them better serve their customers,
22 particularly around financial wellness.

1 So Patrick talked about KeyBank's
2 purchase of HelloWallet, which is a group that
3 provided help for consumers to manage their
4 financial lives and financial wellness, including
5 use of behavioral nudges to help people promote
6 savings and other positive activity. And he talked
7 about, for instance, tying a savings products and
8 the rates that the savings product paid on their
9 loans to the customer's financial wellness score.
10 , so as the financial wellness score went up, their
11 savings rate would go up, as well. So it provides
12 some incentives to both help nudge the consumer to
13 make positive financial choices and then have a
14 defined benefit as a result of that.
15 There are really, from my point of view,
16 three real key take-aways from the panel. The
17 first is that technology is not just for big banks.
18 -- that banks of all sizes can utilize technology.
19 Steven Antonakes, I think, made this point the best.
20 He said the greatestbiggest risk for community
21 banks when it comes to implementing technology is
22 to do nothing. That is the greatest risk. That

1 failure to engage in technology and utilize
2 technology would really put community banks at a
3 disadvantage in the marketplace.
4 The second is one that Doreen mentioned
5 from her panel, which is you use technology to solve
6 a problem -- solve a problem for your customer at
7 least in the retail space. , and that you don't use
8 technology for technology’s sake. That really
9 understanding what is the use case? What does your
10 customer need that they can't do now? What's the
11 friction in the process?
12 So the online ability to apply for the
13 small business loan that Steve Antonakes talked
14 about was something that they used technology to
15 solve that issue -- that particular issue -- and
16 that the banks that were just interested in
17 technology generally, and wanted to take it for a
18 test drive or do something new with it, those were
19 the ones that had the most challenges because they
20 didn't really tie it to a business need of their
21 customer.
22 And then the third point is using

1 technology to leverage your core competencies. So
2 banks are good at risk management and compliance and
3 managing their systems. And they have business
4 strategies. And so figuring out how that
5 technologies can really support and leverage that,
6 the bank's core capacities, was key.
7 MR. MILLER: So my panel, the third
8 panel was really about what we do with all this
9 additional data that banks and other service
10 providers are collecting? Who gets access to it?
11 How do you balance rights and security?
12 We had three panelists: Steve Boms who
13 was representing the Consumer Financial Data Rights
14 Group and, you know, the big data aggregators; Rob
15 Morgan, Vice President of Emerging Technologies at
16 the ABA; and then Lauren Saunders from the National
17 Consumer Law Center, representing the consumer
18 point of view. And in light of time and the stop
19 and seeing Chad ruling with an iron fist, I'm going
20 to go very highly -- I'm going to go touch on the
21 issues that we discussed at a very high level.
22 So the first crucial -- and let me say

1 that this issue is really coming up both as a result
2 of marketplace pressures, you know, the fact that
3 so much data is now being collected from so many
4 different sources. And there's so much
5 sophisticated technology to analyze and slice up
6 that data.
7 And also Section 1033 of the Dodd-Frank
8 Act, which has been broadly read to mean that
9 consumers have a right to their financial data,
10 including letting third parties of their choice
11 access that financial data. , including things
12 like transaction fees, interest rates, terms of
13 loans, and so forth.
14 So the first key issue is asking the
15 question, "Who really owns the consumer's financial
16 data? Who can get access to it and how?" The data
17 aggregators were really of the opinion, as were the
18 consumer -- as was the consumer representative,
19 that it belongs to the consumers and they ought to
20 be able to share it with third-party data
21 aggregators. I'm thinking now of people like
22 Mint.com and others that provide budgeting tools

1 and other financial management tools, --
2 Robo-Advisor, other things like that, -- that are
3 third parties.
4 And the data aggregators see the banks
5 as being uncooperative in their desire to get that
6 data to serve consumers better. The ABA -- Rob
7 Morgan from the ABA -- argued no, we're perfectly
8 happy to share that data with the institutions, but
9 we want to make sure that the security for that data
10 when it leaves the bank is every bit as strong as
11 it is when it's inside the bank. We want to make
12 sure that there's full transparency for consumers.
13 -- that they know who their data is being shared
14 with, how it's being used, and with whom it's being
15 shared, in addition to the people they permission
16 to get it shared.
17 And again, I think the Facebook data
18 sharing was sort of -- changed the discussion a
19 little bit. Between the time we planned this and
20 the time we actually had it, the whole controversy
21 about the fact that people's Facebook data was being
22 shared with people they had no clue -- that they did

1 not give permission to be shared with, I think is
2 sort of one of the things that came up. We did not
3 resolve these issues, but we did look at that.
4 The second big issue is liability. Who
5 is liable in the case of banks -- or in the case of
6 breaches or data getting out? That's obviously an
7 enormously important issue and a point of very
8 serious discussion. The banks are very reluctant
9 to release data, share data if they think they're
10 going to continue to have the liability for that.
11 And I would say that this is -- this is an issue
12 that's four square in front of the regulators. ,
13 and has been the subject of some discussion.
14 Third, the role of community banks.
15 Most of the action right now has really been between
16 the big aggregators and the big banks. In this
17 regard, we're very different, for example, than the
18 EU where most of the -- most of the countries ofin
19 the EU just have a few very big banks. So it's
20 pretty easy to negotiate -- to come up with
21 standards and have everybody buy into it because
22 there aren't that many parties that you need to

1 negotiate with to reach agreement.
2 That's just not the case in the United
3 States. And the consensus here was that the debate
4 for now is really happening between the big banks
5 and the big aggregators. And eventually it will
6 get down to the community banks through people like
7 Jack Henry and Fiserv and FIS and other third-party
8 providers like that. The presumption, I think,
9 behind a lot of this is that eventually that the
10 community banks would want to participate in this
11 at some point because the consumers are going to
12 demand access to these kinds of third-party
13 products.
14 And then lastly, which we just didn't
15 get time to talk much about, but I think is sort of
16 part of the environment that we're talking about
17 here is the rules in the EU. So the UK initiallyUK
18 initially passed an open banking rule. The EU
19 adopted that, and it's actually requiring the banks
20 to develop secure ways of passing along the data to
21 third parties. But the third parties themselves
22 have to be approved and registered and are

1 regulated. So it's a different model, but I think
2 that's sort of -- iIt's called the EU Payment
3 Services Directive 2 -- PSD-2 is the name of it.
4 And I think that sort of serves as a little bit of
5 an example for how things could go in the future.
6 MR. DAVIS: We still have four minutes
7 for questions. Well, if nothing else, would you
8 like to close us?
9 CHAIRMAN MCWILLIAMS: Thank you, sir.
10 I'm happy to do so. I know some people have flights
11 to catch. And I know some of you came from great
12 distances.
13 Thank you again so much for a very robust
14 discussion today. And I look forward to continuing
15 with the committee activities. I mentioned to some
16 of you, next time we'll have an opening hour
17 dedicated to you bringing us your perspectives,
18 maybe with five minute presentation from everybody
19 as to what you're seeing in your markets and your
20 underwriting conditions and everything else that's
21 happening that you can bring as a perspective to us.
22 And with that, I will bid you adieu and

1 see you in October. Thank you so much.

2 (Whereupon, the meeting in the above-entitled matter was concluded at

3 3:27 p.m.)

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