

The Meeting of the Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Washington, D.C.

Open to Public Observation via Webcast

June 1, 2023 - 9:00 A.M.

The meeting of the Federal Deposit Insurance Corporation (FDIC) Advisory Committee on Community Banking (Committee) was called to order by Martin J. Gruenberg, Chairman, FDIC Board of Directors.

Committee members in attendance: Thomas Bates, President and CEO, Legends Bank, Clarksville, Tennessee; Mike Bock, CEO, Dairy State Bank, Rice Lake, Wisconsin; Troy Campbell, President and CEO, Altoona First Savings Bank, Altoona, Pennsylvania; Michael Culhane, President and CEO, North Cambridge Co-operative Bank, Cambridge, Massachusetts; Anita Drentlaw, President and CEO, New Market Bank, New Market, Minnesota; Susan Horton,

; Harold (Hal) Horvat, President, CEO, and Chairman of the Board, Centreville Bank, West Warwick, Rhode Island; Warren Huang, General Counsel, Amerasia Bank, Flushing, New York; Robert James II, Executive Vice President-Director of Strategic Initiatives, Carver State Bank, Savannah, Georgia; Cynthia (Cindy) Kitner, President and CEO, Jefferson Security Bank, Shepherdstown, West Virginia; Trey Maust, Executive Chairman, Lewis and Clark Bank, Oregon City, Oregon; Dominik Mjartan, President and CEO, OPTUS Bank, Columbia, South Carolina; Arlen Osterbuhr, CEO and Chairman of the Board, Minden Exchange Bank and Trust Company, Minden, Nebraska; April Perry, CEO and Chairman of the Board, Kentucky Farmers Bank Corporation, Ashland, Kentucky; Shane Pilarski, President and CEO, Alliance Bank, Francesville, Indiana; Kim Reigelsberger, President, Preferred Bank, Rothville, Missouri; Troy Richards, President, Guaranty Bank & Trust Company, Delhi, Louisiana; Lillous Ann Shoemaker, President, Magnolia State Bank, Bay Springs, Mississippi; and Andrew West, President and CEO, Eagle Bank, Polson, Montana.

June 1, 2023

Vice Chairman Travis J. Hill, Director Jonathan P. McKernan, Director Michael J. Hsu (Acting Comptroller of the Currency), and Director Rohit Chopra (Director, Consumer Financial Protection Bureau) also attended the meeting.

Corporation staff in attendance: John M. Anderlik, James L. Anderson, Rosalind Bennett, Ryan Billingsley, Darren Boyce, Renee Cash, Jermain Cunningham, Angela Dean, Debra A. Decker, Robert M. DiChiara, Doreen R. Eberley, G. Chris Finnegan, George French, Fasil Getachew, Shannon N. Greco, Mark L. Handzlik, Martin D. Henning, Nicholas S. Kazmerski, M. Anthony Lowe, Thomas F. Lyons, Kathryn J. Marks, Brandon Milhorn, Rae-Ann Miller, Patrick M. Mitchell, Mark E. Pearce, Nikita Pearson, Harrel M. Pettway, Jon Pogach, Ariana L. Rambuyan, Jamaal L. Robinson, Betty J. Rudolph, Camille C. Schmidt, Michael E. Shaheen, Kayla J. Shoemaker, Michael Spencer, and Katrice L. Yokley.

Chairman Gruenberg opened the meeting and presided over the proceedings. Doreen R. Eberley, Director, Division of Risk Management Supervision (RMS) and the Committee's Designated Federal Officer, moderated the proceedings.

Introductory Remarks

Chairman Gruenberg welcomed the following new Committee members:

- Thomas Bates, Legends Bank, Clarksville, Tennessee;
- Michael Culhane, North Cambridge Co-Operative Bank, Cambridge, Massachusetts;
- Anita Drentlaw, New Market Bank, New Market, Minnesota;
- Susan Horton, Wheatland Bank, Spokane, Washington;
- Warren Huang, Amerasia Bank, Flushing, New York;
- April Perry, Kentucky Farmers Bank Corporation, Ashland, Kentucky;
- Troy Richards, Guaranty Bank and Trust Company, Delhi, Louisiana; and
- Lillous Ann Shoemaker, Magnolia Bank, Bay Springs, Mississippi.

Chairman Gruenberg then provided an overview of the meeting's agenda. He expressed interest in hearing the members' perspectives on these topics.

Chairman Gruenberg acknowledged Vice Chairman Hill, Director McKernan, and Director Hsu. Vice Chairman Hill commented on the value of the Committee, noting he was looking forward to hearing member feedback on current banking and economic conditions.

Chairman Gruenberg then recognized Ms. Eberley as the meeting's moderator.

Discussion of Banking Conditions

Ms. Eberley introduced John Anderlik, Assistant Director, Division of Insurance and Research (DIR), Robert DiChiara, Regional Manager, DIR, and Camille Schmidt, Section Chief, RMS, to provide an overview of banking conditions with particular emphasis on economic conditions, community bank performance, and credit risk. Ms. Eberley invited the members to provide their thoughts on these topics as well as any other areas of concern.

Economic Conditions

Members commented that the labor market shortages continue to be prevalent across all markets and industries. Members also noted that employers are having a difficult time filling vacancies, particularly for experienced roles. Some members indicated that they have increased staff wages or provided one-time bonuses to retain employees.

Member Bock expressed concern about the ability of service-oriented businesses to meet their full potential if they cannot fully staff. As an example, he related that certain newly constructed nursing homes and assisted living facilities have been forced to keep entire wings closed due to an inability to hire staff.

Community Bank Performance

Members were generally in consensus about community banks experiencing net interest margin (NIM) compression due to higher deposit costs, although most members noted that deposit levels remained relatively stable. Higher deposit costs were attributed to increased competition from online banks and depositors seeking higher-yielding alternatives such as US Treasury securities.

Member Mjartan noted that community banks are facing a "perfect storm" as it relates to interest costs. He highlighted that, after the recent bank failures, some customers have become concerned about placing their deposits at small banks. As a result, some clients are opting to place funds in lower-yielding deposit products at large "Wall Street" banks.

Credit Risk

Members noted that overall asset quality remains stable. Credit risk concerns centered on borrowers' ability to service debt under rising interest rates. Member Maust commented that the office building sector is a source of concern. However, he acknowledged that the impact of potential delinquencies on downtown office building loans is limited as community banks do not generally finance these types of loans. Member Richards also expressed concern about the rapidly rising cost of flood and property insurance and its adverse impact on borrower income.

Several members noted that their banks were experiencing increased loan demand. Member Horvat attributed the high loan demand to regional banks currently limiting activity in the market, partly due to high loan-to-deposit issues. This has given community banks the ability to be selective on loan terms, including interest rates.

Members Reigelsberger and Pilarski provided a contrasting view with respect to loan demand, noting that demand for agricultural loans has declined. Some farmers are opting to self-fund operations due to increased cash reserves. Similarly, other members noted decreased loan demand in single-family residential loans and small business loans due to the higher interest rate environment.

Members expressed that underwriting standards largely remained unchanged. Nonetheless, Member Horton noted lending standards for some industries have tightened. Member James highlighted the importance of testing borrowers' debt service capacity under higher interest rates at origination.

Update from the Minority Depository Institutions (MDI) Subcommittee

Ms. Eberley introduced Committee Member Huang, a member of the MDI Subcommittee and Betty Rudolph, Director, Office of Minority and Community Development Banking, to provide an update from the MDI Subcommittee. Ms. Rudolph began by providing background information about the purpose, goals, and composition of the MDI Subcommittee.

Member Huang announced that the MDI Subcommittee had no current recommendations for the FDIC. He then provided a summary of the discussion topics from the MDI Subcommittee meeting.

Member Huang also mentioned that the FDIC is providing just-in-time training to risk management staff regarding the application of examination ratings to the unique business models of MDIs and that state examiners will be invited to the training as well.

At the conclusion of this discussion, the meeting stood in recess from 10:24 a.m. to 10:47 a.m.

Deposit Insurance Fund Update

The proceedings resumed with Ms. Eberley introducing Patrick Mitchell, Director, DIR, Michael Spencer, Associate Director, DIR, and Kayla Shoemaker, Acting Section Chief, DIR, to present an update on the Deposit Insurance Fund (DIF).

Mr. Spencer led the presentation, centering his update on the level and trend of the DIF reserve ratio. He also discussed the recent issuance of a notice of proposed rulemaking that would create a special assessment to recover the losses to the DIF from recent bank failures. Mr. Spencer emphasized that, under the proposed rule, banking organizations with over \$50 billion in total assets would contribute 95 percent of the special assessment.

Members expressed appreciation that the proposed special assessment will not apply to community banks, but voiced concern about the potential risk to their institutions created by protecting uninsured depositors in the recent bank failures. In particular, some members noted there is a risk that uninsured

deposits at the largest banks are perceived as being safe, while uninsured deposits at community banks are perceived to not have the same protection. One member expressed concern that special assessment costs will be passed down to community banks via correspondent banking services or other indirect methods.

Chairman Gruenberg remarked that the systemic risk exception determination benefited the industry as a whole by limiting contagion risk. He acknowledged it was a consequential decision and that additional communication needs to take place to convey that community bank deposits are at no greater risk currently than in the past.

Director Chopra noted that he shared concerns about this perception risk and the potential funding advantage it can provide for the largest banks.

Options for Deposit Insurance Reform

Ms. Eberley introduced Jon Pogach, Senior Economic Researcher, DIR, and noted that he and Mr. Mitchell would discuss options for deposit insurance reform. They were joined by Rosalind Bennett, Center for Financial Research Executive Program Director, DIR. The panel detailed the three options to reform the deposit insurance system as outlined in the FDIC's Options for Deposit Insurance Reform Report.

Members were complimentary of the report and commended the FDIC for compiling the information. Members suggested that any reforms should provide for a system that is simple for depositors to understand.

Member Richards expressed his concerns about the methodologies banks would need to use to identify business accounts under one of the insurance reform options. Member Mjartan inquired about the deposit insurance assessment calculation, and Mr. Mitchell noted that the definition of the assessment base would have to be changed by Congress. Several members commented on actions they are taking to help their customers and bank employees to better understand deposit insurance.

Chairman Gruenberg reiterated the purpose of the report is to inform public discussion about the options for deposit insurance reform. Chairman Gruenberg further noted that the

option regarding coverage for business payment accounts has the most bipartisan appeal.

At the conclusion of the discussion, the meeting stood in recess from 11:56 a.m. to 1:22 p.m.

Supervision and Policy Updates

The meeting resumed with Ms. Eberley leading a discussion of various supervision and policy-related matters. First, Ryan Billingsley, Deputy Director, RMS, discussed asset-liability management considerations given the rapid interest rate increases experienced over the past 14 months.

Members expressed interest in receiving additional guidance on how to update contingency funding plans and liquidity stress tests given the uncertain economic environment.

Rae-Ann Miller, Senior Deputy Director, RMS, and Thomas Lyons, Associate Director, RMS, then provided an overview of commercial real estate (CRE) priorities and an update regarding the proposed Interagency Policy Statement on Prudent CRE Loan Accommodations and Workouts. Note: the proposed statement was finalized subsequent to the meeting, and published in the *Federal Register* on July 6, 2023.

A number of members expressed interest in seeing the proposed statement finalized. Member Bates highlighted that there appears to be a disconnect between CRE borrowers' debt servicing capacity, which has been impacted by higher interest rates, and appraised property values.

Mr. Lyons followed with brief remarks about an update to the Risk Management Manual of Examination Policies instructions regarding "special mention" designations.

Next, Martin Henning, Deputy Director, RMS, provided an update on ransomware controls and cybersecurity resources.

Ms. Eberley then introduced Chris Finnegan, Senior Deputy Director, Division of Depositor and Consumer Protection (DCP). Mr. Finnegan provided an overview of the Supervisory Guidance on Charging Overdraft Fees for Authorize Positive, Settle Negative (APSN) Transactions.

Members expressed concern about the inability to charge nonsufficient fund (NSF) fees associated with APSN transactions. Member Richards observed that account overdrafts are avoidable on the customer's part. He further noted that NSF fees serve as a deterrent from excessive customer overdrafts and help to offset some of the risk the bank incurs in paying the overdraft. Member Shoemaker asked the FDIC to encourage core processors to assist community banks with system updates that would limit APSNs.

Member Horton also noted that a large banking organization in her area recently eliminated overdraft fees and raised concerns about NSF fee income disappearing for community banks. She highlighted that this is a source of non-interest income and that customers value account overdraft protection and opt-in for the service. Lastly, Member West commented that his bank recently eliminated overdraft fees in part due to market pressures.

Closing Remarks

Chairman Gruenberg thanked the presenters and Committee members for the discussion and feedback. He expressed gratitude to Anthony Capobianco, President and CEO, American Community Bank, Glen Cove, New York, whose term as a member of the Committee expired in April of 2023. He concluded by stating he was looking forward to meeting again in the fall.

There being no further business to discuss, Chairman Gruenberg adjourned the meeting at 2:57 p.m.

Debra A. Decker
Federal Deposit Insurance Corporation
Executive Secretary
and Committee Management Officer
FDIC Advisory Committee on Community Banking

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

Martin J. Gruenberg
Chairman
Board of Directors
Federal Deposit Insurance Corporation