FEDERAL DEPOSIT INSURANCE CORPORATION

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ADVISORY COMMITTEE ON COMMUNITY BANKING

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MEETING

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THURSDAY,
JUNE 1, 2023

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The Advisory Committee convened at 9:00 a.m. EDT in the Federal Deposit Insurance Corporation Board Room at 550 17th Street NW, Washington, DC, with Martin J. Gruenberg, Chairman, presiding.

PRESENT:
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, President, CEO, and Chairman of the Board, Wheatland Bank, Spokane, Washington
HAROLD 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

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 Famers Bank Corporation, Catlettsburg, Kentucky
SHANE PILARSKI, President and CEO, Alliance Bank, Francesville, Indiana
KIM REIGELSBERGER, President, Preferred Bank, Rothville, Missouri
TROY RICHARDS, President, Guaranty Bank and Trust Company, Delhi, Louisiana
LILLOUS ANN SHOEMAKER, President, Magnolia State Bank, Bay Springs, Mississippi
ANDREW WEST, President and CEO, Eagle Bank, Polson, Montana

ALSO PRESENT:

MARTIN J. GRUENBERG, Director, Federal Deposit Insurance Corporation, Chairman
TRAVIS HILL, Director, Federal Deposit Insurance Corporation, Vice Chairman
MICHAEL J. HSU, Acting Comptroller of the Currency
JONATHAN McKERNAN, Director, Federal Deposit Insurance Corporation
ROHIT CHOPRA, Director, Consumer Financial Protection Bureau
JOHN ANDERLIK, Assistant Director, Division of Insurance and Research
ROSALIND BENNETT, Center for Financial Research, CFR Executive Program Director
RYAN BILLINGSLEY, Deputy Director, Division of Risk Management Supervision
ROBERT DiCHIARA, Regional Manager, Division of Insurance and Research
DOREEN EBERLEY, Director, Division of Risk Management Supervision
G. CHRIS FINNEGAN, Senior Deputy Director, Division of Depositor and Consumer Protection
MARTIN HENNING, Deputy Director, Division of Risk Management Supervision
THOMAS LYONS, Associate Director, Division of Risk Management Supervision
PATRICK MITCHELL, Director, Division of Insurance and Research
RAE-ANN MILLER, Senior Deputy Director, Division of Risk Management Supervision
JON POGACH, Senior Economic Researcher, Division of Insurance and Research
BETTY RUDOLPH, National Director, Minority and Community Development Banking
CAMILLE SCHMIDT, Section Chief, Division of Risk Management Supervision
KAYLA SHOEMAKER, Acting Section Chief, Division of Insurance and Research
MICHAEL SPENCER, Associate Director, Division of Insurance and Research

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

9:02 a.m.

CHAIRMAN GRUENBERG: Good morning, everybody. We've got a full house this morning. Thank you all for being here. And, I'd like to call this meeting of the FDIC's Advisory Committee on Community Banking to order. We've got a full agenda today. I think we've got a few things to talk about and very much look forward to your participation and feedback.

Let me start by welcoming a number of new members who are just joining the committee. Let me read off their names if I might: Thomas Bates, the President and CEO of Legends Bank in Clarksville, Tennessee; Michael Culhane, the President and CEO of North Cambridge Co-operative Bank in Cambridge, Massachusetts; Anita Drentlaw, President and CEO of New Market Bank in New Market, Minnesota; Sue Horton, President, CEO, and Board Chair of Wheatland Bank in Spokane, Washington; Warren Huang, General Counsel of

Amerasia Bank in Flushing, New York; April Perry, CEO and Chairman of the Board of Kentucky Farmers Bank Corporation in Ashland, Kentucky; Troy Richards, President of Guaranty Bank & Trust Company in Delhi, Louisiana; Lillous Ann Shoemaker, President of Magnolia State Bank in Bay Springs, Mississippi. We welcome you all. Really delighted to have you on the committee. And, I think you'll find it interesting.

We're joined by three of our Board members this morning. And, I'll give them an opportunity in just a moment if they'd like to make a comment. Let me just provide a quick overview of the agenda for today.

We're going to start our program with a discussion of current banking conditions. I think that our staff will pose some questions on pressing issues. And, we'll really try to elicit your feedback and thoughts.

We'll then follow that panel with an update on our Minority Deposit Insurance

Subcommittee, which held a meeting yesterday. That'll be followed by an update on the Deposit Insurance Fund, as well as a panel that follows that on options for deposit insurance reform which seems to be a topic of interest. And, finally for the final panel of the day, we'll have a series of presentations on updates on supervisory and policy issues.

So, I think we'll have a full day. We'll very much welcome your engagement and look forward to the discussion. And, maybe I can call on Vice Chairman Travis Hill if he wants to say a word.

VICE CHAIRMAN HILL: Well, I just want to welcome everyone today. Thank you all for your time and input and participation today. This has been a very valuable committee in the past and now seems like an especially useful time to hear from all of you. So, look forward to hearing from everyone, and thanks again.

CHAIRMAN GRUENBERG: And, Director

McKernan?

DIRECTOR McKERNAN: Nothing for me.

CHAIRMAN GRUENBERG: And, Controller Hsu?

CONTROLLER HSU: We're good.

CHAIRMAN GRUENBERG: Well, let's get started. And, if I may, I'll turn the program over to Doreen Eberley. I found her. She's, as you all probably know, is the Director of our Division of Risk Management Supervision. And, she'll serve as the moderator for today's meeting. Doreen?

MS. EBERLEY: Thanks, Chairman Gruenberg. So, since we do have several members of our Board of Directors with us today, I have some brief housekeeping remarks. The government in the Sunshine Act imposes notice and access requirements whenever a quorum of the FDIC's Board of Directors meets to conduct or determine agency business.

This meeting is not held for such

purposes and does not constitute a meeting under the Act. The Board members present will only engage in general or preliminary discussions that do not relate to specific proposals for action pending before the FDIC. Any specific issues for official Board resolution will remain open for full consideration by the Board following conclusion of the meeting.

If anybody has any questions, I'll be happy to answer them or not me, but I have others in the room that can answer them. Any questions? Okay, great. We can go ahead and get started. We're going to begin this morning by turning to John Anderlik who is Assistant Director of National and Regional Risk Analysis in our Division of Insurance and Research; Robert DiChiara, Regional Manager in the same division; and Camille Schmidt, Chief of the Risk Insights and Analytics Section in our Division of Risk Management Supervision.

John, Robert, and Camille will provide

an economic overview and touch on industry risks. And, throughout their presentation, we want to hear from committee members regarding your thoughts on these risks as well as any others that are on your mind. We look forward to hearing from you about what you're seeing in your communities. John?

MR. ANDERLIK: All right. Thanks, Doreen. So, the way this is going to work, we have split this session into two sections. I'm first going to talk about a couple of economic issues and then touch on net interest margins from the newly released quarterly banking profile from yesterday.

I'll talk for just three to five minutes, then turn it over to you to hear from you about some of those issues. And, then the second part, Camille and Bob are going to talk through just a few slides on credit risk and then also open up to you. So, most of this session will be you talking to us. I think that's what

we want to hear.

So, let’s turn to the next slide. I have four slides to go through quickly, two economic slides. So, the first slide is one of the major considerations we see in the economy. That’s tight labor market conditions.

And, I always like to start meetings with the bankers’ group with a map that we can all find yourself on the map and see where you are. The first thing to notice, well, first off, this map has four different colors. If you’re one of the brown colors, you’re doing well. Your state is doing well.

The darker brown color are the best five unemployment rates in the country. And, if you’re blue, you’re doing slightly worse than average. The best state in the country is South Dakota with an unemployment rate of 1.9 percent, which is unfathomably low.

And, the highest rate is Nevada at 5.5 percent. And, by the way, these are March

numbers. We wanted to get the April numbers in here. We just didn't meet the press deadline. But, things didn't change much in April.

So, we see some disparity across the country. But, by and large, these are extremely low unemployment rates. And, that's what we keep hearing from economists is this is just the most resilient labor market despite the fact the Fed is raising rates to try to slow things down, to try to tame inflation.

When I looked at Oregon and Illinois in the bottom five at 4.4 percent, that just means we're just in shockingly low times. So, the main takeaway here is labor markets remain very strong despite the Fed's aggressive moves to try to slow things down. Flip slides. And, this slide shows inflation.

We have two different inflation lines. The brown line is the headline CPI. The dark blue line is the core CPI which is CPI less food and energy. And, then the blue line is the Fed

funds rate.

And, you see that after the pandemic, we had a big spike in inflation. The CPI peaked at 9.1 percent in June of ‘22. The core CPI peaked at 6.6 shortly thereafter.

Then the Fed started raising interest rates. We’ve seen ten straight meetings where they’ve raised rates to take the Fed funds target rate from 0.13 percent to 5.13 percent since last March. Those movements have helped CPI moderate to some degree.

The headline CPI is down to 4.9 percent as of April. The core CPI is a little stickier at 5.5 percent. The Fed funds rate, we focus on that. It went up 400 basis points just in the last three quarters of last year and that’s going to be important when we get to the next slide. We had two more rate increase in the first quarter of this year, but that was only 50 basis points. It was a moderation in the rate hikes.

And, what we’ll see on the next slide

is the rapid rise in the Fed funds rate; had enormous impact on bank financial performance, especially community banks. This slide shows -- and like I said, freshly minted. This is as of yesterday, first quarter.

This slide shows community bank and industry net interest margins going back for 15 years. The big story for community banks and the industry in the first quarter was the turn downward in the net interest margins. You can see that on these lines.

We had quite a bit of compression during the pandemic. NIMs bottomed in the first quarter of 2022 at 3.11 percent for community banks and 2.54 percent for the industry. And, then as the Fed raised rates last year in the last three quarters, like I said, 400 basis points, we saw some pretty large increases in NIMs.

Community banks added 60 basis points to their NIMs in the last three quarters of last

year. And, the industry added 83 basis points. But, then, like I said, in the first quarter, we had a moderation in the Fed's actions, only went up 50 basis points.

And, we see a downturn in NIMs for the first quarter. The industry had a narrowing of 7 basis points, and community banks were about three times higher than that at 22 basis points. And, my last slide to tee things up is this is really the reason that we saw a NIM compression in community banks in the first quarter is because the increase in deposit costs exceeded the increase in loan yields.

You see during the second quarter of 2022 and the third quarter of 2022, community bank loan yields were expanding faster than what they're paying on deposits. That was a big boost to NIMs. In the fourth quarter, they actually pretty much caught each other.

We had just a slight gain for deposit costs over yields. But, in the first quarter,

deposits, the funding deposit costs cost 39 basis points more. And, loan yields only went up by 16 basis point. And that 23 basis point gap really fed into the 22 basis point decline we saw in NIMs.

So, with that, I teed a lot of things up for discussion. And we have 20 or 25 minutes to talk about it. But, basically, what I like to hear is for your bank or your market areas, if you want to talk about your labor markets.

I love to hear if your customers are facing tight labor markets. Are you having trouble hiring? How have inflation or interest rates affected your bank?

And, really if we want to talk about net interest margins and deposit flows, I know we're really having to price up deposits. And, if you want to talk about that, I'd love to hear that too. So, with that, I can turn it over to you all.

MEMBER SHOEMAKER: Lillous Shoemaker

from Magnolia State Bank. In regard to the unemployment rate, Mississippi for the last quarter was 3.5 percent. But, it’s interesting, we definitely have seen tightening in the labor market.

But, our seasoned employees are seeking employment elsewhere. We can’t seem to get new employees to hire on at respective wages. And, there’s a lot of job openings, but it’s not reflective of the unemployment rate.

MR. ANDERLIK: Yeah, we see that the JOLTS report came out yesterday. That’s the job openings report, and it was unexpectedly strong, again, to show how many job openings there are in relation to how many jobs are needed. How many jobs employees want to fill is still shockingly high.

MEMBER BOCK: Am I on now?

MR. ANDERLIK: Yeah, there we go.

MEMBER BOCK: With proper staffing, it’d probably increase sales by a million to two

million dollars pretty simply. But, I think the other thing that we're starting to kind of see, we're an area that's starting to have an elderly population, a lot of assisted living, nursing homes, things of that nature. They cannot get the staff they need to take care of the people that are in those facilities.

And, there's been some new facilities been built, financed, et cetera, that are just trying to get off the floor. And, they got wings that closed down because they can't find the staffing to go in there. And, it's going to put us in a new mindset on some of those properties.

You see appraisals where appraisers talk about stabilization rates. We're looking at those industries, especially with newer facilities, of what could be coming down the road for them. They know they need to be occupied at a certain level.

They need a certain room rate. But if they can't put the staff in there the way the

state requires people to be serviced, they are not going to be able to meet those potentials. So, I think that's one of the things we're seeing an area and we're right at the edge of the vacation front.

We have a lot of Ag to the south of us. But our northern rim, there's a lot of vacation. And buyers of restaurants, resorts are having a terrible time getting the staff they need to get the facilities up and running this summer.

So, I think the labor shortage is almost a universal situation around at least the upper Midwest at this point in time. And, it's across all industries. It's not one particular sector.

MEMBER HUANG: I think the short answer for all three of your discussion questions is yes.

(Laughter.)

MEMBER HUANG: Warren Huang, Amerasia

Bank in New York. I echo the tight labor market that was just presented. So, maybe I'll tackle the second one or the third.

We've been having a pretty difficult time with net interest margin compression. Deposit rates in our neck of the woods has been quite strong and rising rapidly. Our customers are coming in with internet printouts of online banks and saying this Fintech or this non-FDIC bank are coming in with this interest rate. Can you match it?

And, a lot of times, we cannot. So, we're also having a race to the bottom in terms of CRE loans where when it was at 7-8 percent, a lot of our customers are balking at those costs. And, for us, we understand. Their debt service can't handle it.

So, we've been working with our customers to try to get a reasonable accommodation. But, that's definitely been a pressure for us. But, we're trying to do what we

can for our customers, both on the deposit and on the loan side.

MEMBER MJARTAN: Good morning. This is Dominik Mjartan. I’m with OPTUS Bank. We’re maybe a little bit unique, but I see two trends that I wanted to highlight for the team.

From our perspective, I think the, first and foremost I think we’re in a little bit of a perfect storm in terms of the interest costs. The 500 basis point increase, those of us that have very sticky mission driven relationships certainly not being affected in terms of outflow of deposits. But in terms of cost of funds, I think we’re feeling the pressure.

We do have a concentration of large depositors that want to bank with us because of the relationship banking services and the mission that we offer to them -- the mission premium that we offer to them as a small minority-owned community development bank. So, we’ve not lost any deposits. We felt no pressure at all.

Where we're feeling significant pressure is in our cost. And, further increasing that pressure is what I call the panic buying deposits and panic pricing of deposits. There is a panic premium that we're starting to pay as a small bank partially because of the migration to the larger institutions.

I can share a couple examples without naming any names where we had customers that committed to move their significant relationships to us - business accounts. And, then following the SVB, they all backed off and actually moved their relationships to the large Wall Street banks at a substantially lower rate that we were offering them. And, so that's one trend.

And, then the other trend too further making that worse, I think, there is a permanent migration, at least we're seeing some our communities, of those deposits. And, so, on top of just liquidity flowing out of the banking system, a little bit into other places, the panic

buying of deposits, the premium that we're having to pay. And, I see that migration to these large, too big to fail institutions.

I do have grave concerns, not actually about our liquidity position or our ability to meet the needs of communities, but long-term growth and then the net interest margin compression. One point I would very much echo what Warren shared, the NIM compression is real because there's only so much that a customer can handle in terms of debt service. So, going from 4 percent to 6 percent was doable. Going from 6 percent to 8 percent, that cash flow doesn't necessarily work out.

While we are having to pay up to upwards 4 and in some cases even 5 percent on deposits as an industry, definitely the ability to pass on some of that increase nominally to our customers doesn't seem to be there. Simultaneously, the loan demand is very strong. We're continuing to see strong demand.

Maybe it's because of our mission, because how we're known in those communities. But, we're getting flooded with requests, with referrals from other banks. They want us to help. They want us to serve.

As they're pulling back, they see that our loan deposit ratio is still below 100. So, they want to reach out to us. And, say I guess you have some room on your balance sheet, so can you help us out? And, we have to say, look, unless there's liquidity attached to it, unless there's a primary banking relationship or the loans are pledgeable, we're also taking a pause which is really detrimental to the most vulnerable, what I call underestimated communities in America. They're going to feel this pain first.

And, so, if I had to say one grave concern, I think the immediate pain is going to be felt in communities like Mississippi and communities in South Carolina or Georgia that our

or Robert's bank serves. The impact is probably going to hit there first. Because of that, the more underestimated, underserved communities, regardless of their high potential, are going to probably feel that pinch of credit access first.

MEMBER HORTON: I would echo all the comments. I'm Susan Horton, by the way, with Wheatland Bank. We're headquartered in Spokane, Washington, Eastern Washington.

In addressing the NIM, I would just add to that going into this environment before rates were risen so quickly, we actually had the 99th percentile of the lowest cost of funds in our UBPR group. So, we enjoyed a 0.03 cost of funds. Fifty-one percent of our deposits were non-interest bearing.

What we're struggling with, the one thing we haven't touched on yet here in this meeting is these large investment portfolios on all of our books. A third of our balance sheet because of all the growth from the PPP that we

participated in. We grew from about 480 million to 650 million almost overnight.

All of those funds went into safe, short-term investments, yielding about 1.5 percent. Our duration is 3.4 years, but we're living with that. And, we're not selling them and recognizing the losses.

But, we are recognizing those losses in a reduced yield on assets every single month. You combine that with the borrowing cost because we don't want to sell investments. Our loan growth has been over 20 percent year over year.

So, we are funding that loan growth using the new Fed borrowing facilities. So, that comes at a cost today of about 5.15 percent. So, when you have one and a half percent yielding investments, you're borrowing to fund loan growth at 5.15.

That really puts pressure on that net interest margin. So that's what we're feeling in a big way. Thirty-one percent of our deposits

are non-insured.

And, so the main competition that we feel for deposits, credit unions and U.S. treasury instruments. We haven't seen as much outflow to the too big to fail banks. But, we are seeing that pressure for yield.

And, we've seen about 5 percent year-over-year of deposit outflow. So, I think liquidity, the resources are there to hold to maturity. But, when customers, like you say, are wanting 4 to 5 percent and you have a one and a half percent investment portfolio, that really constrains your margin.

MEMBER HORVAT: I'm Hal Horvat. I'm from West Warwick, Rhode Island. We're about a 2.2 billion dollar bank, and we do a lot of commercial loans in and throughout New England.

I would echo the comments about NIM and some of the deposit issues. But, the one thing I would add is what's interesting right now is loan demand is through the roof right now. We

had anticipated probably a 20 percent drop in our commercial loan production for this year, and we're probably looking at a 20 percent increase.

A lot of that is driven by other banks being out of the market. A lot of the regional banks that are our competitors, they're kind of on the sidelines right now. They have loan to deposit issues that we don't have.

So, we're looking at more deals than we ever thought we would have to. What's interesting, we also can name our terms a little bit more. We can kind of dictate a rate going forward. So, that'll help us with NIM going forward. And, the structure is something that we can dictate as well which is kind of a nice issue to have as we go into this.

MEMBER BATES: My name is Thomas Bates. I'm from Clarksville, Tennessee. We're a suburb of Nashville, and we participate in both communities.

I can echo a lot of the same

sentiments. Loan demand has been very strong this year. We have historically been a CRE bank, and so we’re getting overrun with requests and we’re having to really take a close look at things.

It’s really boiling down to trying to stick with fundamentals. I mean, just trying to focus on relationships and not transactions is what we’ve been trying to do. We’ve been able to hold on to our liquidity fairly well.

Prices or rates are obviously going up. We have several very large credit unions in our Clarksville market. We are home to a military base.

We have some of the largest in the country that we have to compete with. But, we have been able to hold on to a good amount of core deposits. And, the NIM is okay.

It’s not what we want it to be, but it’s better than I thought it was going to be. Our biggest issue, we can manage the cost funds

and the risk. It's really the labor market, and the cost of banking talent has really grown.

Just the amount of money that we've had to do. And, special one-time raises to keep employees has really been a big factor. And, finding experienced talent, we have an older lending base.

So, we're really having to focus on training new people that are younger because you can't afford to go get a new lender from a competitor because you'll have to pay a tremendous premium these days. So, we have really been focusing on trying to grow talent. But, it just takes time, and that's a little frustrating. But, we think it'll pay off in the long run.

MEMBER RICHARDS: Good morning. I'm Troy Richards from Guaranty Bank in Northeast Louisiana. We're in the Delta, so we've been in an economic slump for the past 100 years or so.

(Laughter.)

MEMBER RICHARDS: But, we've seen some pressure on net interest margin. We've gone from about 4.16 to 3.91. So, I think we're still doing pretty good on our margin.

We've seen a deposit rate increases much faster than loan rates, of course, like everybody. Been a lot of pressure to price loans at or below prime which, of course, we don't want to do. Our customers want us to do that, but we don't.

With consumer lending, there's, as you know, no negotiating on loan rates. It's strictly rate sheet only. On commercial loans, there's a lot more negotiating that takes place on commercial loans.

1071 becomes reality. That'll go away. And, so we're not looking forward to that at all. For the majority of our loan officers, they've not experienced a time that we're in right now.

This is all new to them. It's harder

to sell money when rates are going up. And that's what we do, we sell money. We don't build anything. We just sell money.

It's very easy to buy it, but it's quite a different matter to sell it when rates are on the rise. As far as supporting a healthy NIM, we don't try to be the highest rate payer on the block. And, we let some deposits walk as a result.

And, we've seen some of them walk. We make no apologies on the loan side for the higher loan rates and try to sell our quick decisioning and our one-on-one service to help soften the blow on the loan rate. The biggest aide I think for us and a healthy NIM has been our desire to stay short.

We don't price loans for more than five years. We don't buy investments with maturities longer than two. And, it's been our motto and I think it served us well.

I think some of the banks that we've

been hearing about in the news could've taken that advice to heart and not extended those maturities. We've had banks in our market area when rates were so low for so long extend maturities on loans, pricing loans for ten years. It might've been a good decision when they made it, but not so good of a decision now.

As far as inflation, we've seen it. The cost of everything is going up, wage inflation, cost of healthcare. All that affects the bottom line. Our customers are finding it difficult as well to earn as much revenue so they can pay their loans the way they should.

We faired fairly well on our past due percentage. It's a little higher but still at a comfortable level. Inflation to a business is in some ways like a business tax. They pass it on to the ultimate consumer.

The rise in interest rates has been positive for our bank. We're a very asset sensitive bank. So, our CEO likes to say when

rates go up, we make more money.

And, we've seen that to be the case. We've never priced loans, like I said, for very long. And, we miss out on some deals because of that. We feel like that's a decision that's in our best interest and the best interest of our borrowers.

So, obviously, interest income on Fed funds has mushroomed as has the interest rates on our loan portfolio. The increase in the rates on loans, the whole point of the raising interest rates is to slow everything down. We've actually not seen too much of a slowdown as has been echoed by some of the other banks.

Our loan volume is up, and our deposits are down, which has put some pressure on our liquidity percentage. But we still feel like at about 22 percent we're doing pretty good as far as liquidity. But, it is something that we're watching.

Where's the bottom going to be is the

question that we all have. When is the deposit runoff going to stop? And, if anybody has any words of wisdom on that, I'd like for you to share it.

MEMBER JAMES: Good morning, Robert James, II, Carver State Bank in Savannah, Georgia. We're a little unique in many ways, Black-owned MDI bank, been around about 100 years in the Savannah market. I'm also CEO of our holding company.

And, last year, we acquired another institution, Alamerica Bank in Birmingham, Alabama. So, we're a multi-bank holding company. So, on the labor conditions, yes, our customers and our institutions are impacted by the tight labor markets in both Georgia and Alabama. We're at the lowest end of the spectrum in terms of unemployment rates.

And, I echo many of my colleagues' concerns about the challenge of finding particularly bank talent, experienced community

bankers. Dominik and I had dinner last night. And, we're talking about the fact that we have a handful of 60-plus year-old women who really run our banks. And, trying to find the people who can step into those roles and replace them is going to be a real challenge for us going forward.

Increasing wages, we've taken some steps to increase wages across the board, made those kind of special one-time increases to recognize the hard work of our staff over the last few years. In the Savannah market, in particular, we have some really huge manufacturing operations that are coming into that market and building -- there's a giant EV charging -- an EV plant being built just outside of Savannah with all of the attendant suppliers that are going to locate. So, we have billions of dollars of new investment coming into the market which is fantastic.

But, we're also bracing for the competition from these large multi-national

corporations that are going to come in and raise wages across our entire market. So, we're bracing for that competition. So, we've taken some preemptive steps.

And, then we're going to probably have to move wages higher. Because we're in an expansion mode and we have the two-bank holding company structure, we can hire some remote workers. So, that's taken some of the blow away.

But, when you start to hire people in Metro Atlanta or hire people in higher cost markets, then that just is increasing our costs. Yes, we are being impacted by inflation and rising rates. And, we don't have a current liquidity problem.

But, we got capital that's right now being held back in our holding company and not deployed directly into the bank because of the issues around hiring new people to be able to deploy that capital prudently, but also being able to acquire the liquidity that we we'll need

to leverage that capital up and doing it at rates that won't reset our cost of funds kind of fundamentally and structurally across the institution. So, there's some challenges there. We have the benefit of being a mission-driven CDFI bank and people are attracted to the mission.

And, I think that we can attract large kind of mission-driven deposits at lower costs. But, it's still going to end up being 150 basis points higher than our actual cost of funds. And, so, you're talking about restructuring our overall cost of funds is something that we're being really careful about.

In terms of NIM, historically, we've had very, very high NIMs. And, we have experienced some compression. But, a lot of that I think is being mitigated by the fact that we're adding higher quality assets to the balance sheet.

So, as our bank has grown, we've

started to be able to sort of climb and be able to do larger, more sophisticated kinds of loans, which have generally speaking been better performing assets. So, we have also historic -- right now, we have -- we've always had pretty low loss rates on our balance sheet. But, we have historically low loss rates and past due percentages on our balance sheet right now.

So, I think that we're benefitting a little bit from higher asset quality. Loan demand continues to be extremely strong. And, we need to stress opportunities to ensure our ability to perform -- ensure the customers are able to perform if rates continue to rise.

So, we're seeing strong demand. But, we're having to really stress those loan applications to make sure that those kinds of -- those businesses could perform if rates continue to rise. So, there's a trick. I see some smiles here. It's tricky math to do to make sure that you can -- that those customers are going to be

able to pay if the rates reset.

MEMBER PERRY: I'm April Perry with Kentucky Farmer's Bank.

MR. ANDERLIK: April, we'll do you and then we'll go to the second half.

MEMBER PERRY: Okay. I was just going to say as far as being concerned about customers being able to perform, that's something that we've really been looking at because over the past year, we know what interest rates have done. And, we had customers that took out construction loans to build houses. And, most of those construction loans have gone longer than what was expected because of supply chain issues. And, now you see your customers that thought that they were going to have a mortgage at a certain rate and a certain payment.

And, their rate is much higher. Their payment is going to be much higher. And, it's concerning to think that a customer could build their dream home and then not be able to afford

it because of the rising interest rates.

And, although we've been told for years that we should stress our balance sheets by 4 percent, who would've ever thought that it could happen in such a short period of time. And, I think that's been very difficult for the banks, and also just for the people that have debt.

MS. SCHMIDT: All right. Thank you, April. And, we'll move on to the next portion and discuss credit risk. Bob and I are going to make a few comments. And, then, again, you will have plenty of time to tell us what's going on in your markets.

So, I'm going to start out with commercial real estate. That remains the bread and butter for many institutions. Ninety-eight percent of banks hold CRE loans, and CRE was the largest loan category for almost half the banks in the industry.

If you look at this chart, you can see that CRE loans held by the banking industry have

increased every single quarter since first quarter of 2013. And, they've reached a record -- an industry record of more than three trillion dollars at the end of March. CRE loans comprise a quarter of total loans held by the banking industry and about 13 percent of total banking assets.

Again, looking at the chart, you can see that loans for existing non-farm, non-residential real estate properties, that green bar, make up the largest portion of the industry's CRE loan portfolio at nearly 60 percent. Multi-family loans are the second largest loan category. And, that's followed by acquisition, development, and construction loans, that dark blue bar, also called construction and development or ADC.

This has historically been the highest risk CRE loan type. I haven't shown it on this chart, but unfunded CRE loan commitments have been high. They decreased a little bit last

quarter, but they did hit a record high at the end of the year and remained above last cycle's peak.

So, there's plenty of CRE loans in the pipeline. On the next slide, Mike, I'm going to talk about the number of banks with CRE loan concentrations, and that's certainly grown. Again, this is fresh off the press.

But, overall, 1,402 banks have a concentration of total CRE loans greater than 300 percent of Tier 1 capital and reserves or of ADC loans greater than 100 percent. And, that's as of March. This is up by 85 banks since last year.

As a percentage of banks, the figure sits it about 30 percent. That's down from the 35 percent that we saw at the end of 2009 going into the recession. I mentioned earlier that ADC has been the riskiest loan type.

Back in fourth quarter 2007, we had hit a peak. And, the number of banks with ADC concentrations was about 2,374. That's just

below 400 now, so quite a bit different scenario. I've kind of set the stage for what we're seeing in CRE loans. Now, I'm going to let Bob talk about what we're seeing in CRE market conditions.

MR. DiCHIARA: Thank you, Camille. Good morning. So, if you look at this slide here, we like to look at commercial real estate markets through the lens of the property types. And, one fundamental measure, of course, is vacancy rate.

And, you can see here this is the vacancy rate by property type nationally over time. And, you can see that office really has the lead on everyone else. And, that makes a lot of sense with what's happening in the office market.

That's really been the most strained property type really coming out of the pandemic. We see that office attendance, which is actually foot traffic in offices, is about one-half of what it was pre-pandemic. Now, of course this varies by market but really not that much.

There are some markets like San Francisco that are very low in terms of return to office. There are some markets in Dallas -- Houston and Dallas -- the City of Dallas are a little bit higher. But, it's a fraction of what it was pre-pandemic.

So, there's been a very slow return, and companies are looking at how much space they really need going forward as leases come due. And, when we talk about leases coming due, we look at really three risks in a given market at this point that are really causing some strain. So, we tend to focus on markets where there are a lot of leases coming due.

And, we've done some studies of that where there are a lot of loans coming due. And, we use the commercial mortgage-backed securities market to measure that, and then at the same time, a high vacancy or availability rate. If you have those three problems coming together at once in the midst of high interest rates that some of the

folks have talked about in their lending book, that becomes the issue.

So, for the next couple of years, we have what we call this refinancing risk which I'm sure you're experiencing with your borrowers where there's going to be some strain, particularly in the office market where the fundamentals of the property income are not going to be there to support this new debt as leases come due at arguably one of the worst times you can come due when you have vacancy rates at 15-20 percent. Some markets have the total availability rate which includes some sublet space that companies are still paying, but trying to get out of in excess of 25 percent vacancy. So, those are some areas that we watch in that area.

So, certainly office is a focus for us. You can see multi-family also if you just stay on that chart for a second. So, multi-family, the vacancy rate is even rising in multi-

family nationally.

And, it may be surprising when you listen to the news and you see your own markets where demand for housing is through the roof. People are looking for apartments, either lines to get into apartments to rent or just heavy demand for rentals. What's happening in the multi-family market, though, is that is demand starting to soften and the construction has been extremely high. We'll take a look at that in a minute.

The other two property types I have on the chart there, industrial has been extremely strong with the demand for logistic space. Companies like Amazon, of course, have needed space to meet the demand of online shopping and all the delivery and everything that goes with it. But, even Amazon has said in the last year that they have too much space.

And, the construction and vacancy has -- construction in industrial has been

significant. There was more space built in the last four years in industrial than in the prior 12-year period. So, it's been significant.

But, with vacancies at 20-year lows, it looks like there's some more room for that asset class and that property type to outperform. And, then finally retail, at the beginning of the pandemic, we started to see they could see rates go up. But, what really saved retail from the retail apocalypse that also of folks referred to when the pandemic hit was that there was not a lot of new construction in retail in the last 20 years.

The 1980s were the decade that a lot of construction was built. A lot of new properties were built. And, then the '90s and 2000s, not so much nationally.

There's two real issues in retail I would just highlight quickly. One is the mall space, the superregional malls. They do have vacancy rates that are double the rest of the

retail sector.

And, we started to look at retail vacancy rates for properties in office buildings. So, even in an office building, you have four or five retail establishments. And, in every market we've looked at, the vacancy rates are a magnitude of double or triple what the vacancy rate is in retail for the rest of that market. So, that's an area of focus too.

On the next slide, I know some of the folks in this room and I know regional and community banks have a fairly heavy investment in multi-family, especially in the Northeast and some of the markets where housing is a focus for them. And, if you look at this chart, you can see the completions have been very strong. That's the blue bars.

Completions have really been strong for the past decade. And, up until now, absorption has kept up. That's the shaded blue area.

But, you can see in late ‘22 and really projected into the rest of 2023, construction is expected to outpace demand. And, that’s where we start to look, why we see the vacancy rate rising. Of course, this is worse in some markets more than others, but it’s certainly an area of focus for us and I know for some of you with multi-family lending.

And, then finally on the last slide, when we talk about what’s important to the community banks, we are showing here what the market share has been for community and regional banks across the property types. I get this question a lot. What types of lending are the community banks in?

Are they in office? Are they in some of the problem asset classes and property types? And, we don’t collect a lot of information from banks. Specifically, as you know the Call Report is very blunt. It measures multi-family and it measures non-farm, non-residential as the other

category largely.

But, we use some other data and we've been able to ascertain that they're really involved across the spectrum, retail and surprisingly hotel. This may be more hotel-motel. But, there's quite a bit of market share in those property types and industrial as well which is why I mentioned some of those, the trends going on in industrial. So, I'll turn it back over to Camille at this point, and we can throw out some questions and hope to hear from you.

MS. SCHMIDT: Thanks, Bob. I just had a couple more areas on the next slide. I want to talk about some key developments in the housing market area. As you all know, annual home priced growth was strong in 2022.

But, we saw it decelerating and it slowed down to single digits by year end. Home price growth is expected to continue to be slow in 2023. In fact, several housing experts have suggested a decline in national home prices by

the end of the year.

Forecasts range from a decline of between 1.6 percent up to a 10 percent lost in value. Of course, there's still some other outliers that are predicting a positive but much slower actual growth rate of maybe even up to 3 percent by January. Here at the FDIC, I think we think tight inventory and strong demand from Millennials will likely support normalized home price growth going forward and limit any outright collapse in home prices.

As you know, the sharp rise in mortgage rates in 2022 made the cost of borrowing higher and led to a sharp decline in mortgage originations. And, I'm sure we'll hear about some of those issues from you. So, that's all I'll say there.

I want to close with just talking about consumer a little bit. Consumer credit outstanding continues to grow and that includes auto loans, student loans, and other loans.

Credit card balances were flat this quarter, and that kind of bucked the trend for the first quarter.

Normally, we see those balances decline following the holidays. So, those were flat. But, we continue to see very good growth in auto loan balances, again, retail cards and other consumer loans and student loans balances. Those stand at 1.6 trillion and they were up this quarter.

Of course, we've all read a debt ceiling deal will probably reinstate those student loan payments. So, that's something to watch. I want to talk about some emerging risk here.

In this chart, we look at the share of credit card borrowers that are transferring into delinquency by age. And, we're looking at delinquency being over 90 days past due. And, we note that borrowers in their 20s and 30s are transitioning into some serious delinquency.

Again, these are less established borrowers. And, I think this is kind of a sign of early emerging risk in the consumer area. Banks have tightened their lending standards on consumer loans in the past year.

And, according to the Fed's senior loan officer survey, they plan to continue tightening through 2023. So, we're also interested to know if that's the case in your institutions. So, with that, we've got some questions.

Again, what risk trends most concern you? How would you -- some of you already alluded to the rough demand. But, I'd be interested to hear from all of you on that. And, then how are you adjusting your lending standards in this current environment? And any other thing you would like to talk about.

MEMBER REIGELSBERGER: Does that work? Okay. Kim Reigelsberger with Preferred Bank in Rothville, Missouri. Primarily we're an

agricultural bank. We see a lot of cattle herds and soybeans and corn.

Thinking about our cost of funds, before COVID, we were looking to increase our loan to deposit ratio. COVID hit. We got flush with deposits.

That made that ratio kind of seem poor. But, we still have a lot of those deposits. So, actually, we feel like the rising rate environment is going to be beneficial to us.

And, so as rates have gone up, we have tried our best not to be that bank that's competing with our competition to who can have the highest rates. But, we've been able -- some of the bigger national markets have taken a few of our deposits, but not much. We still have a lot.

But, then on the lending side of it, because we've been able to keep some of our deposit rates somewhat where they were before the increase in Fed rates, we haven't really adjusted

our loan rates up the same. We tried to keep that if we're going to pay out lower, let's maybe lend out a little bit lower. So, we've been able to do that this year for our farm operating loans.

Usually, if we think about prime rate, we kind of reserve that or below for our prime customers. But, right now, all of our farm loans are under prime just because our deposit rates are still low. So, we're kind of keeping that in mind.

But, as far as agriculture, they're really doing very well. If you remember as I do in the spring of last year, commodity rates hit almost the highest they've ever been. And they had -- those that have excess commodities on hand were able to take advantage of it.

So, this year, we're not seeing quite as many farm operating. Some of them we're still funding a little bit. But, that's part of the deposits that are sitting in our accounts is they were flush with the sale of grain last year.

And, so, we feel like even though some of that would be used for -- to fund their operating, I assume it's not hot money -- we think it'll stay. But, one thing we have seen, we don't do a lot of one-to-four family construction type loans. However, this year, we've only done two.

I mean, for us, a big year is maybe if we do a dozen. We're thinking, oh, my gosh, what's everybody doing building a house? But, right now, we've only done a couple.

And, the thing that's changed, in our area, everybody builds with a basement. Everybody builds with a basement. The last year and a half, nobody -- all the brand-new homes we've seen have been a slab home.

The cost of building a home has just jumped up through COVID. So, that's been something I've found very interesting. And, the last six or eight months, the borrowers have been 50 and older, not that I'm keeping track.

I just know them. They are my

friends. So, I know how old they are. They're getting ready for retirement. And, so, in their mind to kind of rein in the cost it is to build a new house these days and make it affordable so they can retire at a good time, they're eliminating one thing and that's a basement.

I know it sounds kind of silly. But, in our area, that is something that -- a basement these days can cost fifty, sixty thousand dollars. And, if you can chop that down by two-thirds on that price.

But, anyway, right now, our loans seem to be -- they're not strong. But, our interest rates are rather low. I think people are just more cautious. At least that's kind of what we're seeing at this time.

MEMBER PILARSKI: I'll piggyback off Kim. So, Shane Pilarski, Alliance Bank which is in Northwest Indiana. So, primarily an Ag bank as well. But, over these last few years as the commodity prices have been really high.

And, then operating interest rates have grown. Our farmers have seen the value of using their cash for their operations. So, our demand there as well as I'll throw in the continued competition from farm credit, we're just not seeing that demand or loan volume from our Ag. We're under 60 percent loan to deposit.

So, we have money to loan, really low cost of funds. So, our CRE portfolio has grown because that's where the opportunity is. So, as far as what's most concern, what credit risk is most concern to our bank, it's becoming a building CRE portfolio where we were more of an Ag bank. So, it's increasing our knowledge, putting in those monitoring things that we haven't really had to focus on before to make sure that we're managing that risk in this growing area for our bank.

MEMBER KITNER: Good morning. I'm Cindy Kitner with Jefferson Security Bank. We're located in the eastern panhandle of West Virginia

which is about 90 miles from here and about the same distance from Baltimore as well. It creates some interesting -- different scenarios and circumstances is what I've heard this morning.

And, I'd like to go back to some of the labor focuses and others. What we've been used to over many years is the commuters that come into northern Virginia and Maryland and even into D.C. So, from a housing perspective, we've generally had strong housing demand.

And, obviously through the pandemic, some of the shifts and changes that we've seen is more in a remote work environment. That demand continued and is very strong. From a labor perspective, those wages have continued to push up.

So, where in the past we would have individuals in our market that understood, they may be able to get higher wages. But, that would come with an hour to two-hour commute, sometimes two hours each way. Now, that commute has been

eliminated, pushing our wages up even higher.

In addition to that, we are located in a proximity close to major interstates. And, that has brought in a lot of industry. And, so for us, some of our larger employers include healthcare and education.

But, then we also have one of the five distribution centers in the U.S. of Procter and Gamble. And, right across the state line, we have an Amazon distribution center. We also have a local horse racetrack with a casino.

And, Clorox is another manufacturer that just came in. So, there are ample employment opportunities in our area. We have the lowest unemployment within our state.

And, those wage pressures are certainly a big concern. Some of the other concerns I would echo so many of the comments that we've heard here today in regards to deposit cost and the cost of funds. From a credit perspective, I really hope that the housing

values do stay up.

That is a big concern for us. We are a large real estate lender. We watch those values very carefully. Some of the things that we have seen, and I'd be curious to see if others have heard or are seeing this.

But, we're hearing that some of the national builders in our area who handled their own financing are continuing to sell lots at lower interest rates because their fear is that the supply will outpace and they don't want to see that. So, they're continuing to move the lot sales through lower interest rates, again, through their own lending programs. And, I'd be curious to hear others are seeing or hearing anything in that regard.

As far as looking at the credit risk, we had the opportunity to bring on some additional experienced credit management very recently and which we've done. And, we are certainly digging deeper into our portfolio and

looking at things in different ways. And, I think adding those resources when the opportunity presents itself is very important.

But, it is hard to continue to keep the right level of oversight on some of the credit concerns and issues. So, those are some of the key points that I just wanted to add this morning. Thank you.

MEMBER DRENTLAW: Good morning. Anita Drentlaw with New Market Bank, Elko, New Market, Lakeville, and Prior Lake, Minnesota, just 20 minutes south of the Twin Cities area. So, we're still in the suburban area I would say or the seven-county metro area, but right on the outskirts of farmland.

We really are a commercial real estate bank. I mean, back before the great recession, we did a lot of construction development because that was what we had around us, but have transitioned heavily into more of the commercial real estate, really owner occupied. So, to us,

it's more of underwriting the business just like you would a C&I loan because it's the business that's repaying the loan.

Our credit risk trends for our actual bank are actually -- I see it more in the industry just as a whole. There's been a lot of multi-family apartments basically being built in the Twin Cities area. We don't have a lot of that.

We actually have zero past dues right now and have for the last few quarters. So, I think our underwriting is extremely strong and it has been because we learned some stuff during the recession and so have changed a lot of our underwriting and credit risk management practices. But, as far as demand for lending, it's somewhat slower.

And, I think some of it is because of people being cautious right now. Rates are higher. We still have some demand, and I do -- somebody said it over there that a lower loan to deposit ratio which we have at around 60 percent

has really given us the opportunity to be a lender for people.

There's a lot of banks in our -- several banks in our area that are running 90, 95, 100 percent loan to deposit which is giving them not a lot of room to be able to extend credit. So, I feel like we have an opportunity to be able to underwrite prudently and still be able to actually do new credits. That being said, we have really not -- I'm not going to say tightened our lending standards except for really looking more at full relationships within our customer base, focusing on -- we want the deposit relationship just as much as the loan relationship and challenging our lenders to bring a deposit with them if they're bringing on a new credit.

And, the participation market has dried up somewhat too in Minnesota I think because of higher loan to deposit ratios. So, people are holding on to that extra liquidity and

saving it for deals that are in their own areas rather than necessarily participating out. The final thing I would say is we do a lot of mortgages.

We have a large mortgage department. And, that has dropped quite significantly, mostly because of rate. But, talking with our mortgage lenders, they're still having issues being able to get purchasers' offers accepted.

So, there's still quite a competitive market in our area for homes. So, you'll still see multiple offers on homes. And, a lot of times, they're just not being able to close loans because they can't get their offer accepted because somebody else came in higher. So, there's still a shortage, I guess, I would say of the moderately priced single-family homes in our area.

MEMBER RICHARDS: I would say a credit risk trend that's a concern to us has been insurance. Primarily on two fronts, flood

insurance, a big one. We were in D.C. last year, met with the FEMA head. And, he was kind of proud of the fact that premiums might only increase 18 percent for the next five years which is about 100 percent increase in premium.

We've had borrowers who have had some sizable increases in their flood insurance premiums. We're in Louisiana. I mean, what do you expect.

But, we've actually gone so far as to limit loaning on properties that are in a flood zone. So, that's been a concern of ours. Not only that, but property insurance has been a major issue in our state.

Insurance carriers are leaving the state. If we have another named storm this year, then it's going to be disastrous for Louisiana. We've seen premiums and deductible amounts really mushroom.

The church where I attend, our deductible went from 2,500 dollars to 25,000

dollars. Basically, they don't want to pay for roofs. Insurance companies are depreciating roofs.

I never knew that was such a thing, but it is. And, so insurance, when we underwrite a loan now, we have to take into consideration what the insurance premiums are now and what they could go to. And, can they still make their note payment? Sometimes the flood insurance premium might be more than what the loan payment is. So, that's a real concern in our part of the world.

MEMBER HORTON: If I could, on the three questions, the credit risk trends like your bank, we have zero non-accruals. And, over the last ten years have a net charge-off ratio of net recovery. So, really zero charge-offs over ten years.

Twenty-five percent of our loan portfolio is Ag. And, a lot of those are tied to prime production loans. So, they're yielding 9.2 percent.

We have not gone subprime. We may have one or two borrowers at prime. But, we're still able to charge based on prime.

That helped a little bit with that investment portfolio. But, a couple of trends that we're really seeing, we've had strong 20 percent loan growth. We are seeing credit unions have a bigger liquidity issue than the community banks and regional banks do.

And, for the first time, we're seeing credit unions charge a higher rate on CRE loans than banks are. We've had borrowers come to us and express that and say they're shocked with that too. And, so, credit is tight in our area.

So, we have also, because of liquidity and everything, tightened our credit a little bit through our policies. So, our debt service coverage ratios, where they were at 1.25, we've just recently tightened those to 1.35, for certain industries that we perceive to be higher risk. Hospitality, for example, would be one of

those.

So, we definitely are looking at that. We also aren't doing large non-owner occupied CRE loans without a full primary deposit relationship. So, we're really making sure that we've got that full relationship.

If we're going to do that kind of lending, we tend to focus more on owner occupied. So, yes, we've adjusted our lending standards. Demand is very, very strong.

In terms of credit risk, it's great. Credit quality is great right now. We're seeing-- Ag has been very strong. We're seeing a little bit of softening in Ag in certain commodities where they have excess of inventory on hand from the prior years and, of course, are growing this year's crop, in particular, I think the hay market in Washington state.

And, so, we're very diversified within Ag. And, we also have a lot of international exporters. But, we are seeing hay values drop.

Wheat is down.

So, we're being cautious about the future of Ag because it's been very, very strong. So those are kind of my responses to your questions. Thank you.

MEMBER CAMPBELL: Troy Campbell from Altoona First Savings Bank in West Central, PA. We have two things going on with commercial lending. First, we do work with a lot of restaurants.

And, so, it's been trying to help them understand the cash flow and revenue and income are two different things. The government has flooded so much money into the system, especially for restaurants. So, they think they've had the greatest years of their lives.

And, we're trying to explain, you've had a lot of cash influx, but the performance hasn't been strong. The second thing is we're very active in the revitalization of our community; we're a mutual savings bank. And, so

we have very established borrowers that are very entrepreneurial and get into new ventures.

Now a lot of those new ventures are based on forecasts. And, so, with the higher interest rates, those forecasts don't look as favorable as they did when you were back in the 4 percent, 5 percent range. So, we've definitely experienced a slow down in loan demand.

I would say probably about 2 percent off year-over-year in our small business lending. We don't get into non-owner occupied real estate. Pretty much everything we do is owner occupied or one-to-four family investment properties because we are located pretty close to Penn State University.

So, loan demand is off. We haven't changed our underwriting standards because we have always had very strong underwriting standards. Our charge-off activity has been -- historically has been very low and it continues to be low. But yeah, so our biggest thing has

been the higher interest rates and the fact that we deal a lot with forecasts for projecting performance of a business has definitely resulted in a slowdown in demand.

MEMBER SHOEMAKER: Just a few more comments. Today marks the opening of hurricane season. And, so Troy, I echo those comments that we've had a lot of insurance carriers pull out of the Southeast and no longer willing to underwrite our properties.

Mortgage originations are definitely down. We are a consumer, CRE, and one-to-four family lender. What we're seeing, Cindy, is that our builders are holding the properties in their inventory.

They're not necessarily reselling them. But, what concerns me with the migration to the Southern states that we've seen throughout the pandemic that housing costs are almost unaffordable in the one-to-four family arena. But, wages to your comment are not -- they're

traditionally lower in the south.

And, so, we’ve got to come up with a way to balance home prices versus wages. So, that’s definitely a concern. We’re definitely analyzing the full relationship with our borrowers, and we have always maintained very tight lending conditions.

MEMBER MAUST: Morning. Trey Maust, Lewis & Clark Bank, headquartered in the Portland market, so Oregon and southwest Washington. I wanted to comment on a couple of asset classes. So, when we look at -- we’ve been in the past a highly concentrated CRE bank.

It was our primary business model since the inception of the bank. Since then, we’re now below the threshold. So, that’s been kind of an interesting turn of events.

But, the discipline that’s been established since the financial crisis including enhanced risk management practices, separate committee to focus on lending risk and a lot of

other really forward looking and obviously historically looking practices. It's been very helpful in us really assessing the trends over time. The two asset classes that I'm probably most concerned about on a macro scale, I don't necessarily know it's going to affect the community banking industry at large.

But, the office is a concerning, one from a return-to-work perspective or a return-to-office perspective, particularly in a central business districts of each of the major metros and even some of the Tier 2 and maybe 3 metros as well. I don't know that we finance a lot of those as an industry. Institutional investors, REITs, et cetera, are probably going to get hit pretty hard when those leases come due for renewal and also as rates and repricing starts to happen with respect to interest rates and the debt service.

The one thing that was interesting to see, though, is it affecting the suburban markets or areas outside of the central business

district. And, what I can tell you is that I was in downtown Portland on Friday and I remember 20, 30 years ago working in downtown Portland. It was packed with foot traffic.

There was maybe one person per block as I was looking around at 7:45 in the morning which is kind of shocking. As you move outside that just that central business area, parking lots are full. People are in the office. They're in retail establishments. They're obviously at home.

So, I feel pretty good about what that bodes from the standpoint of community banks and maybe some of the larger regionals as well. With respect to multi-family, I think we're probably going to experience the impact of demographics, shifting through different life stages. So, we had the very large baby boom generation, very large millennial generation.

When it comes to Gen X and Gen Z, those are much smaller. I think those are the

individuals, talk about Gen Z starting to shift into that stage in life where they are looking for apartments. Millennials buying houses, buying a lot of goods and services.

I think that's going to continue to put pressure on obviously the housing market and then, of course, the economy at large as well when you look at inflation and just demand for goods and services. But, I do have a concern about the ability for absorption to occur. I think we're going to see elevated vacancy rates.

And, again, I don't know from a community banking perspective, it's quite possible that we have a handle on that given the smaller projects that we typically finance as opposed to the very large buildings and projects. The one thing I will mention, and Doreen, I made this comment last time. It was about ALM where, as a bank, we are living that ALM.

It's no longer a scenario analysis. We've expanded the number of scenarios because

we've now got experience with what happens if. I will say on the CRE side, it was a struggle, I think, during the financial crisis to deal with the adversely classified assets that were on the balance sheet, work through those with borrowers, and at the same time, start to enhance those risk management practices.

It was a lot of work that had to be undertaken by a bank and banks in general who are concentrated on CRE. I will say, though, that I do appreciate now the position it puts us in to be prepared for what's coming next. And, we've expanded that.

I imagine everyone here has as well to any other loan area where there's a concentration or an expected concentration or they're entering into a new asset class. So, I did want to at least comment on that. Probably don't get a lot of thank yous for forcing us to do something. But I do have to say it's helped us a lot. So, thanks.

MS. EBERLEY: Thank you, Trey. And we’ll have an additional conversation about that this afternoon. So, look forward to your input in that conversation as well.

This was a terrific conversation. Thank you. Really appreciate all the engagement. I think some of the themes that I heard from the conversation is that there’s some staffing challenges around the country.

Loan demand was mixed. So, some places, I heard very strong to not so much. Some new considerations in underwriting, or not new but additional emphasis in terms of the costs of insurance and the increasing rates on borrowers and kind of projecting that out with potential further increases.

Deposits, I think I would characterize from what I heard here. You can shake your heads yes or no. Kind of stable but costing more for sure, stable-ish. Stable-ish? Okay.

But, overall, strong asset quality.

Things are looking pretty good. So, still managing through. So, really appreciate the great conversation and the feedback from you. Thank you.

All right. And, thank you to our presenters. I really appreciate it. Next up, we're going to recap a meeting we had yesterday with our Minority Depository Institutions subcommittee, or the MDI subcommittee.

And, Warren Huang serves on both this committee and the MDI subcommittee. And Warren and Betty Rudolph, the Director of our Office of Minority and Community Development Banking, are going to provide us with an update from yesterday's meeting. So, I'll turn it over to Betty.

MS. RUDOLPH: Thanks, Doreen. I wanted to briefly -- is my microphone on? How about now? Okay, great. I wanted to briefly remind the committee that the FDIC established the MDI subcommittee under the authority of the

Advisory Committee on Community Banking under this committee.

And, the Federal Advisory Committee Act requires that subcommittees like the MDI subcommittee provide advice or recommendations through their parent committees. So, the MDI subcommittee reports to all of you and not to the FDIC. So, our goals are to serve as a source of feedback for the FDIC on strategies to fulfill our five statutory goals with respect to MDIs, provide a platform to promote MDIs and collaboration partnerships and best practices, and identify ways to highlight the work of MDIs in their communities.

We have nine executives from across the country, MDI executives representing a diversity of types of MDIs. So, we have Native American, African American, Hispanic, Asian American, and a range of business model size and geographic mix. So, the nine members of our MDI subcommittee represent about 10 percent of all 99

MDIs that the FDIC supervises.

In addition, we have four MDIs represented on this committee, Robert James, II, Dominik Mjartan, Andrew West, Eagle Bank, and Warren Huang with Amerasia Bank. So yesterday, we met. And, Warren is going to give an update on our meeting from yesterday.

MEMBER HUANG: I got two mics. Thank you, Betty. At this time, the MDI subcommittee does not have any recommendations for the FDIC. But, the subcommittee does want to share a brief recap of yesterday's meeting.

At yesterday's meeting, we discussed current banking conditions and unique issues facing our institutions. Many of the themes included stiff competition on deposit pricing from other banks, non-bank online lenders and Fintechs, keeping a close eye on our commercial real estate, inflation, rising interest rates, significant labor shortages affecting our banks as well as the local businesses that we serve,

housing shortages, and rising cost of homeownership. There was overall little to no deterioration on asset quality and mixed experiences with loan demand.

Most of the MDIs did not experience deposit outflows from the events of the past 12 weeks. Many of the banks indicated that they were resilient while positioned for the effects of the rising interest rates. During the MDI spotlight, we heard from three private funds that are supporting minority depository institutions with a variety of resources, including the MDI Keepers Fund, the Mission Driven Bank Fund, and the Black Economic Development Fund.

MDI subcommittee members found the member -- sorry. The subcommittee members found the presentations to be useful. And, the FDIC will place the videos on the website so MDIs across the country can learn about these resources.

We also had a brief briefing from FDIC

staff on the recent bank failures affecting the Deposit Insurance Fund, or DIF, followed by information on the FDIC’s Board’s recent vote on the special assessment to recoup losses to the DIF. And, we also received a briefing from staff on policy options for changes to the deposit insurance based on recent paper released by the FDIC. Next, we had updates on the results of the FDIC’s 2023 MDI program effectiveness survey.

A briefing and discussion about the 2023 Interagency MDI CDFI bank conference and update on examiner training. The survey showed that the FDIC is generally meeting its 12 goals. MDI bank has found technical assistance to be useful or very useful and found it to be good, very good, or outstanding in enabling their institutions to address topics presented.

The survey showed that MDIs would like technical assistance to be more specific, but provided no further suggestions at this time. We learned about the 2023 interagency conference

which will be more interactive than in the past. The conference will take place in November at the Federal Reserve Bank of Dallas. And, the FDIC recently sent save the date information to all MDIs and CDFIs.

The FDIC is providing quarterly just in time refresher training for FDIC risk management EICs and other supervisory staff for upcoming examinations on the application of exam ratings to unique business models of MDIs. The training will include case studies on applying exam ratings to MDI business models, cover information about new mission driven capital inflows to MDIs, and supervisory expectations regarding management of capital and risk-related new capital. State examiners will also be invited to attend. And, that concludes the report from the subcommittee. And, Betty and I welcome any questions you may have.

MEMBER JAMES: Great report.

(Laughter.)

MEMBER SHOEMAKER: It’s interesting. Your comments were exactly like our comments from the previous segment, same concerns.

MS. EBERLEY: They were, yeah. Okay. Well, next on our agenda is to transition to a break. We will take a break, and please return and be ready to start back up at 10:45.

(Whereupon, the above-entitled matter went off the record at 10:24 a.m. and resumed at 10:47 a.m.)

MS. EBERLEY: All right. Welcome back, everybody. Before we being our next session, I’d like to acknowledge Rohit Chopra, Director of the Consumer Financial Protection Bureau and a member of the FDIC Board of Directors has joined us for this segment of the meeting. Thank you. And, I wanted to offer you the opportunity to say a few words if you’d like.

DIRECTOR CHOPRA: I’ll pause until the presentation part.

MS. EBERLEY: Okay. Thank you. All

right. So, next, we're going to hear from representatives from the FDIC's Division of Insurance and Research. Pat Mitchell, the Division Director; Mike Spencer, Associate Director of the Financial and Risk Management Branch; and Kayla Shoemaker, Acting Chief of the Banking and Regulatory Section are going to provide us with an update of the FDIC's Deposit Insurance Fund.

MR. MITCHELL: Just want to make -- okay. So, thank you, Doreen. And, as Doreen mentioned, I'm the Division Director for our Division of Insurance and Research.

And, I'm going to open up briefly, then I'm going to hand it over to Mike and Kayla to talk about the details. So, DIR, our Division of Insurance and Research, since the events in March have been quite busy. We weren't actively involved in the resolution nor the supervision of the institutions.

But, of course, there's been some very

important follow-on work. And, we're going to cover two of those areas over the next two sessions. So, first, these are back-to-back sessions, and they are related but they're not.

First, we're going to cover the Deposit Insurance Fund, and also the NPR, the notice of proposed rulemaking, on the special assessment related to the coverage of the uninsured depositors of Silicon Valley Bank and Signature. And, we're also going to -- the second session, we're going to cover options regarding deposit insurance. And, for those that aren't aware, we have a paper out there.

And, so, we'll cover that, and Jon Pogach will come up here and join me for that. Having said that, again, we've been busy. They're related to each other and happy to connect the two and answer questions in advance of Jon.

But, we will cover in detail the options paper and talk through. And, we'd love

to hear your thoughts on kind of what we -- when we say we, it's Congress really. But, what you think might work from a deposit insurance reform. So, with that, I'm going to hand it over to Mike to walk through the Deposit Insurance Fund update and the special assessment.

MR. SPENCER: Thanks, Pat. Good morning, everyone. First, I'll provide a brief update for the DIF. And, then as Pat mentioned, after that, I'll cover the special assessment rulemaking that was just recently proposed.

If you can turn your attention to the chart on the screen, I think you might also have a printout which illustrates the historical DIF reserve ratio. So, the black line matches up to the right axis and the DIF balance on the gold bars matching up to the left axis. As of March 31st, the reserve ratio which is the fund balance relative to insured deposits, measure 1.11 percent down from 1.25 percent at year-end.

And, the DIF balance was 116.1 billion

dollars, down approximately 12.1 billion dollars from year-end 2022. The vast majority of the decline in the DIF was driven by the failure of two banks and amounts set aside for the anticipated failure of First Republic Bank, which subsequently failed after the first quarter. The decline in the DIF balance was partially offset by assessment income, which increased by about a billion dollars from the previous quarter, largely because of the two basis point increase to the deposit insurance assessment rate schedules that became effective on January 1st, 2023, and which we spoke about the last time we presented to you in mid-2022.

Insured deposits increased by 2.5 percent during the first quarter, a little bit higher than the average we usually experience in a first quarter, bringing year-over-year insured deposit growth to 3.1 percent. So together, the decrease in the DIF balance and the increase in insured deposits is what caused the reserve ratio

to fall to 1.11 percent. We're currently operating under a Restoration Plan that was adopted on September 15th, 2020, that would return the reserve ratio to 1.35 percent, the statutory minimum, by September 30th, 2028, as required by law.

And, in spite of the recent stress, the reserve ratio currently remains on track to reach 1.35 percent by that statutory deadline. We'll continue to monitor factors affecting the reserve ratio such as insured deposit growth, potential losses due to bank failures, and related reserves as required under the Restoration Plan. And, we'll continue to update the Board at least semiannually.

Importantly the decline in the DIF balance does not include the cost of protecting uninsured depositors pursuant to the systemic risk determination made for the two bank failures that occurred in March. The FDIC is required by statute to recover those losses through special

assessments which offsets the losses associated with protecting uninsured depositors and eliminates any effect on the DIF balance and reserve ratio.

So, I plan to discuss the special assessment next, but I can pause there if there's any questions before heading into that. Okay. So, on May 11th, the Board approved an NPR to impose a special assessment to recover the losses arising from the protection of uninsured depositors again as required by law and in connection with the systemic risk determination. That was announced on March 12th, 2023, following the closures of Silicon Valley Bank and Signature Bank.

Specifically, the law requires us to consider the types of entities that benefitted from the action taken or assistance provided under the determination of systemic risk, the economic conditions, industry effects, and any other factors that we would deem appropriate and

relevant relative to the facts and circumstances at the time. Also, the law provides the FDIC with the discretion in the design and time frame of any special assessment to recover the losses. And, before covering these factors and the design, we'll start with the losses attributable to covering uninsured depositors under the systemic risk determination.

And, currently, the estimated losses between the two banks total at 18.5 billion dollars. And, of that, the estimated loss attributable to protecting uninsured depositors was 15.8 billion dollars at the two banks. These loss estimates will be periodically adjusted as the receivership works through its processes and assets are sold, liabilities are satisfied, and receivership expenses are incurred.

To recover this amount, this 15.8 billion dollars, the proposal would impose an annual special assessment rate of 12 and a half basis points on the applicable banks. So,

regarding that scope of application under the proposal an IDI's assessment base for this special assessment would be equal to estimated uninsured deposits as of December 31st, 2022, adjusted to exclude the first 5 billion dollars of uninsured deposits. And, that's applicable either to the IDI, if an IDI is not a subsidiary of a holding company, or at the banking organization level to the extent that an IDI is part of a holding company with one or more subsidiary IDIs.

And, under this methodology, we estimate that 113 banking organizations would be subject to the special assessment. Banking organizations with total assets over 50 billion dollars would pay more than 95 percent of the special assessment. No banking organizations under 5 billion dollars in total assets would be subject to the special assessment.

This approach and result is consistent with our statutory requirement to consider the

entities that benefitted from the systemic risk determination. In general, large banks with large amounts of uninsured deposits were the principal beneficiaries of the systemic risk determination. The largest banks also benefitted the most from the stability provided under the systemic risk determination.

So, as proposed, banks of larger asset sizes and that hold greater amounts of uninsured deposits will pay a higher proportion of the special assessment. As far as timing, the special assessment would be collected beginning with the first quarterly assessment period in 2024, so that's January 1st, 2024 to March 31st, 2024. Since we collect in arrears on the first payment would be at the end of the second quarter of 2024, providing an appropriate amount of time for planning.

Also, to preserve liquidity and to keep the assessment consistent and predictable, the payments will be collected over eight

quarters. If prior to the end of the eight quarters, the loss is lower than the amount expected, the FDIC would cease collection. Alternatively, if the loss exceeds the amount we've collected at the end of that collection period, we can extend it as needed.

Pivoting to the effects on capital and income, while we would collect the estimated loss over this initial eight-quarter special assessment collection period under GAAP, applicable banking organizations may recognize an expense for the assessment immediately. So, because of this, it's assumed that the effects to capital and income of the covered banks would occur in one quarter only. For those banking organizations, we estimate that the proposed special assessment would result in an average one-quarter reduction in income of 17.5 percent and a decline in the dollar amount of Tier 1 capital of less than one percent.

Finally, the NPR was published in the

Federal Register on May 22nd. It's open for a 60-day comment period that ends on July 21st. And, after this period ends, we'll carefully consider all the comments with the aim of finalizing the rule in October of this year and, again, with an effective date of starting in January 2024.

And, so just as a reminder, we are in an open comment period. So, we encourage anyone who is interested in commenting, they can do so through the official comment process which can be done through our FDIC's website. Thank you. Any questions?

MEMBER RICHARDS: Michael, we're certainly appreciative of the fact that community banks are not going to be paying the special assessment. When all this came about, there was some worry that we might have to pick up part of the bill. Was that ever in the realm of possibility?

MR. MITCHELL: Yeah, we have

alternatives. I mean, and I guess we looked at the statute. And, again, looking at the statute, looking who benefitted the most, we thought the proposal that we put forth made sense.

But, of course, we look forward to comments. So, I think we were considering any type of possibility that would meet the statute. And, we do have a number of alternatives for people to comment on.

MEMBER RICHARDS: Is there a possibility that through the comments that you all might come to a different conclusion?

MR. MITCHELL: We'll wait for the comments. That's all we really can say. But, again, we put forth what we thought best met the statute and best met the statutory requirement that of course the Board will – the Board is the one that has to ultimately approve. But, we'll wait for the comments.

MEMBER RICHARDS: So, you would encourage comments from community banks as well

and --

MR. MITCHELL: Absolutely.

MEMBER RICHARDS: -- keep it as planned?

MR. MITCHELL: I think that's the case. We always search for comments from everybody. But, yes, I think to the extent that you're supportive of the proposal, yes, we also want to see those comments too. Sometimes people think, oh, we just want to see comments saying, oh, here's what we think you should change. But, we also want to understand the support.

MEMBER PERRY: I appreciate the fact that the community banks will not have to pay for this through the special assessment. But, I don't think we can kid ourselves into thinking that we're not going to pay for it also because to the extent that we use these larger banks for correspondent services, those costs will be passed down to us. So, I think that's something that everybody is going to be paying for, maybe

not directly but indirectly.

MR. MITCHELL: Sure. I mean, I think to be clear, I mean, I think obviously we would prefer not to have to do a special assessment. But, given the statutory requirement and again the circumstances, that's the best solution. I think what we put forth is looking at the statute, so --

MEMBER WEST: Can I ask you a question real quick? What about flight to safety in terms of consumers coming under the impression that the FDIC is always going to bail out after bigger banks? Therefore, their money is safer in a bigger bank and they're going to leave the community bank with their money.

Have you guys talked about that? Or I'm sure it's been brought up. But, I'd like to hear your thoughts on that. I haven't personally seen anything, but some of my colleagues have talked about that. And, it's a grave concern to some of the smaller banks that people's

perceptions are that if you're at B of A or someone big that if they get in trouble, that your deposits are going to be safe, but not necessarily at a smaller bank where maybe nobody cares if we go under.

MR. MITCHELL: I mean, I think what we've seen and this was played out a little bit in the media. I think what we've seen, the actual results have not shown quite as strong of a pull to the larger institutions as what was played out in the public. So far, no, that's true. But, I mean, I think there's a catalyst there that was pretty strong. I think if nothing else, I feel like the community banks have proven very resilient in that we actually saw insured deposit growth this quarter stronger despite the event. So --

MEMBER WEST: That's good news.

MR. MITCHELL: -- now I think we're going to talk a little bit in the next session about options for changing deposit insurance

which we'll love to hear your thoughts on that and address it.

MEMBER WEST: Thank you.

MEMBER JAMES: To Andrew's point, I serve on a corporate advisory board. And, it's a privately held company. And, I was in the meeting a couple weeks ago, and this company, they've got -- they wouldn't be considered a small business technically.

I mean, they've got a couple hundred million dollars in cash reserves. And, so, we got to the portion of the meeting where the CFO was giving his report. And, he was walking through their banking relationships.

He was reporting out on their banking relationships. And, they keep their money in a couple of what I would consider to be superregional institutions. And, he talked about the due diligence they had done on those institutions, the fact that they're monitoring what's going on at SVB and Signature and First

Republic.

And, they were very confident in the strength of the institutions and the fact that they had reciprocal insurance where necessary on these deposits. It was really interesting to hear some of the non-banker members of this advisory board after he gave all of this report and he talked about the strength of these institutions which I consider to be extremely well capitalized, huge banks. They said, well, we should still look at moving our money to JP or Wells or a G-SIB.

And, I thought that was a really interesting, very telling comment. And, these were very sophisticated business people who listen to a report that said that their banking -- that their money was safe. The company's monies were safe.

They had no exposure to SVB. This company has some technology, but they had no exposure to SVB. And, even after all of that,

they directed the CFO to look at moving the relationships.

And, I thought that was really telling. So, I do think -- and I mentioned this to the Chairman last night. I do think that what the FDIC and the other regulators did was the correct move. And, you stopped a run on banks that would have been catastrophic for all of us.

But, I do think that there is still vulnerability in the system. And, I think there's this perception that the four or five largest banks in the country are being kept safe regardless. And, I think that the actions that the FDIC and the other regulators and policymakers take to communicate that our banks, community banks, are still extremely strong and extremely safe. I think that there's more things that can be done to communicate that to the sophisticated folks who are moving money based on their perception that the G-SIBs are going to be kept whole regardless.

MEMBER RICHARDS: I saw a letter from a large bank that they actually were sending out to their customers advertising the fact that all their deposits will be covered because they were. And, it's one of the three that you mentioned. I saw it with my own eyes.

CHAIRMAN GRUENBERG: Yeah, we'd be interested in seeing that letter because that would be a misrepresentation of deposit insurance. So, that would be relevant for us to know.

MEMBER RICHARDS: It was being passed around, let's say, among some of the community banks.

CHAIRMAN GRUENBERG: A couple of points probably worth making. The decision to protect the uninsured depositors at Silicon Valley Bank and Signature was a very consequential decision. As you know, it was not made lightly.

I think there was a genuine concern

that there was contagion risk triggered by the failure of Silicon Valley Bank, that it impacted Signature, and that other banks over that initial weekend were showing significant stress. So, that if we did not act, the risk of other institutions being significantly impacted up and down, the banking industry appeared to be genuine. And, I think that's what prompted the Federal Reserve, the FDIC, and the OCC to recommend.

And, then the Treasury Secretary in consultation with the President to determine to exercise the systemic risk exception to protect the uninsured depositors. In retrospect, we certainly don't second guess that decision. And, I think it benefitted the industry as a whole. And, we'd be in a more difficult position today if we had not done that.

And, I think community banks among others benefitted from that. So, I really don't second guess that. It was a consequential

decision that raises serious issues in regard to deposit insurance.

We're going to talk about that in the next part of this discussion as why the FDIC in a relatively compressed time frame produced a pretty comprehensive study of deposit insurance to try to inform the discussion around this issue. I will say and have said that while in the initial aftermath of the first two bank failures, there was impact on deposits that seems to have settled down. The third institution that failed, we were able to do under the least cost test without exercising a systemic risk exception which we thought was actually a significant example to set.

And, as a general matter as we've discussed and as we've noted, liquidity at community banks has generally remained stable during this whole period. And, no reason to think that deposits at a community bank are at any greater risk today than before. I think there's

still communication around this issue to do.

But, it was a tough set of circumstances to deal with. I think we made, frankly, the best decisions available to us in the moment that have generally been proved out by subsequent events. Still things to pay close attention to.

But, I agree with the point that community banks have actually come through this quite well. Your deposits have remained stable. As a sector of our banking industry, you all continue to do quite well as you all have discussed this morning.

So, we'll take it a day at a time. That's kind of my mantra here. But, I think -- and I do think the point and I think I could ask staff to comment further on this. To the extent there's been movement of deposits, there's been some to the larger institutions, but not frankly that much.

To the extent there's been movement,

some of it has actually been to insured deposits because of this. Some of it has been outside of the banking system to money market funds is seeking higher yield actually. So, it's not a simple picture. But, I do think from a community bank perspective, frankly it's been a fairly positive one. And that's --

MR. MITCHELL: Yeah, and I'll just add on to what the Chairman said there. I mean, again, the numbers don't fully bear out the story that's being told in the press regarding this huge flow. And, you talked about earlier, I think there's a bit of a -- some people have termed it as an awakening by depositors about receiving higher interest rates. And, you all talked about that.

And, some of them are going to money market funds. And, that seems to be the larger flow as opposed into the larger institutions. So, that's the numbers. And, again, this is something we talked about this at the – the

Chairman mentioned this at the QBP yesterday. We're going to be acutely interested to see what second quarter numbers look like because that's going to tell a little bit more beyond the -- I guess more of the persistent story as opposed to the two- or three-week story at the end of the quarter.

DIRECTOR CHOPRA: Let me just offer a couple of comments as we transition to the next section. I apologize. I can't see your name, sir. But I don't want to -- I think what Mr. West has said regardless of whether the data is showing it, the perception he mentioned is a big problem.

You don't want your depositors feeling, oh, it's safer there. And, I think that is something we have a lot we're doing to make sure that we take away that perception because the funding advantage for a too big to fail bank is not only in what they can actually execute. But, it's also that perception that they benefit

from.

And, it is not a good thing. Let me also just say a couple of other points. The reason I really wanted to make sure I came here was that what Patrick just talked about, about thinking again about whether their deposits are insured or not, today the CFPB released an analysis of these very popular payment apps, Venmo, CashApp, all of them, Google Pay, Apple Pay.

And, what we find is about three in four adults are now using them. And, actually, I think it was about 85 percent of those 18 to 29 use them. So, we expect that adoption will continue to surge.

And, we estimate that there are billions of dollars sitting in stored balances. And, the way it works, I'm sure most of you are familiar, when you send money, an ACH debits your account. It goes to the user.

But, when you receive, it does not

necessary go into your insured bank or credit union account. And, those payment apps are sitting on those balances. They are not subject to traditional bank regulation in terms of what they're doing with it.

And, in our own analysis of the fine print, it's very clear that not all of those funds are insured. It might be insured if they technically put it in a partner bank. And, it's a little bit complex.

But, it's one of many situations where you see that a consumer individual business might perceive, oh, this is just like a bank account. It is not. And, I think we are trying to figure out ways and we have published a nationwide consumer advisory today encouraging people when they receive funds, sweep it back to their insured account.

We encourage others to help with this. And, it's another place where we fear there is a perception of stability in something that is not

in the meltdown of FTX and others. It was not just people who lost their crypto currencies. They also had dollar funds deposited in those accounts which were then not necessarily secure and segregated.

So, I encourage you to look at what we've published. I think it's also useful. There's a lot of issues with these apps including when something goes wrong, consumers can't always get answers.

And, then they go to their local bank to say, help me with this, especially when there's a problem. And, this is not sustainable. So, we will -- as you know, we will continue to talk about an CFPB community bank advisory committee.

But, I wanted to share that with all of you. Just two other brief points to build on what the Chairman said, I think that we really made -- it was a tough decision to do it. And, the proposal that we have voted on actually is

not a community bank exemption.

In fact, a large bank if it was 100 percent insured deposits will not pay anything. So, it's really on larger firms with more than 5 billion of uninsured deposits which I think really maps well to our legal requirements. And, the Chairman and the staff I think really came up with a very, very good way to allocate the costs and the benefits.

Although, we will acknowledge that the failure of First Republic is not subject to that, I continue to look at that reserve ratio and think to myself really the hits to that fund come from big institutions, not from smaller ones. And, we have to, I think, over the long term assess, are the costs being put on the ones who really create those hits to the fund given the greater simplicity of resolution of smaller ones? So, sorry to go on and on, but I just want to keep everyone in mind about all of this other stuff that feels secure but is really uninsured.

MS. EBERLEY: Okay. Thank you. We'll treat that as a segue to our next topic. So, thank you very much. Pat is going to stay with us for our next agenda item, and he's going to be joined by Jon Pogach, a senior economic researcher in our Division of Insurance and Research. And, they'll talk about our paper on deposit insurance reforms.

MR. MITCHELL: Even though she doesn't have a name tag, I'm going to ask Rosalind to come up here also, please. So, Rosalind was out on vacation. And, Jon and Rosalind are the two primary authors of the deposit insurance paper.

It took a village for sure. But, Jon and Rosalind were the primary pen holders. So, now I think we're really -- I think Jon's going to help us touch on some of the aspects we were just talking about, about, for example, the customer you were talking about with business -- not to front run, but business payment accounts is what we call them and talk about the kind of

the characteristics in some of the things we think -- we've recommended to think about with regard to if we're going to change. If deposit insurance is to change, what are some key things to consider?

I'll mention that -- I think the Chairman mentioned we have a short time frame. Obviously, deposit insurance is a key part of financial stability. And, clearly, that did not work the way everybody expected based upon the events of Silicon Valley and Signature.

So, the Chairman asked us to help inform the discussion that we knew would ensure and asked us and asked me and the Division of Insurance and Research to produce an options paper. And, I said, okay, probably maybe four to five months. And, he said, how about four to five weeks?

And, by the way, I think that's actually looking back, it's important for us to have produced something. And, Jon and Rosalind

both delivered to help inform the discussion. I think we've done that. And, with that, I'll hand it over to Jon, just talk about what we wrote in the paper.

MR. POGACH: All right. Thank you, Pat. So good morning, everyone. Thank you for the opportunity to present this overview of our report which is entitled Options for Deposit Insurance Reform. It appears on our website. And, we certainly encourage everyone to read it. That's why we wrote it.

I also want to thank all the great staff that worked on it. It was very much a village effort. So, our report is a comprehensive overview of the deposit insurance system and presents options for reform to address the current risks facing the system.

So, I'll spend about ten minutes highlighting and summarizing certain areas. And, then I can turn it over to questions. So first, the report analyzes relevant trends in deposits.

In particular, uninsured deposits have trended up over time and have increased the risk of bank runs. At their peak in 2021, the portion of uninsured deposits in the banking system was also 47 percent, which is higher than at any time since 1949. Large concentrations of uninsured deposits increase the potential for bank runs and can threaten financial stability.

Technological changes such as the speed with which information or misinformation is disseminated. And the speed with which depositors can withdraw funds can also increase the risk of bank runs. The report examines the objectives of deposit insurance.

One primary objective highlighted by Pat is to promote financial stability. Bank runs destroy value and they disrupt the provision of credit. Individual depositors who lose access to their funds and bank failures may not be able to meet their obligations which can amplify stress to businesses and households.

In addition, a run at one bank can also lead to contagion as depositors at similar banks look to withdraw their funds. Even for banks that don't experience a run, they can contract credit which can reduce economic activity and can lead to job losses. Deposit insurance reduces these risks.

Another objective of deposit insurance is protecting small depositors. As of year-end 2022, more than 99 percent of deposit accounts were under the 250,000 deposit insurance limit. Deposit insurance protects the savings of small depositors.

The report then describes possible consequences of deposit insurance. Banks practice in sound risk management, incorporate the risks associated with deposit withdrawals into their decision making. Deposit insurance reduces the need for banks to manage their risk taking in response to the risk of uninsured deposit withdrawals.

Changes to deposit insurance must consider both the financial stability benefits of more coverage and the possible implications for risk taking in the banking system. The report also discusses additional consequences of deposit insurance such as possible changes to bank funding which also merit consideration when evaluating reforms. The effectiveness of deposit insurance depends on how it is used with other policy tools.

Regulation and supervision play important roles in constraining risk taking incentives and supporting financial stability. Tools such as capital requirements and supervision of bank growth can reduce risk taking incentives that might arise from deposit insurance. And, regulation and supervision of liquidity can also be used to help reduce run risk.

Long-term debt requirements can also increase financial stability by facilitating bank

resolutions and can also reduce risk taking by increasing discipline from debt holders. The report also discusses new policies such as requiring collateralization of large uninsured depositors or limiting their withdrawal capacity both of which may also complement the other reforms. Requiring the collateralization of large uninsured deposits with high quality short-term assets would reduce the ability of banks to rely on concentrated uninsured deposits to fund their long-term assets.

As a result, banks and large uninsured depositors will be forced to share some of the financial stability cost that might be associated with such accounts. Limiting the withdrawal capacity of large uninsured deposits, for example, by requiring that a certain portion of such accounts cannot be withdrawn with a fixed time frame would also increase the exposure of large depositors to banks at failure. Limited withdrawal capacity would also increase

monitoring sensors for large depositors, but suppress incentives to incite panic and would encourage depositors possibly to diversify their funds more broadly across banks.

A more diversified depositor base may then contribute further to financial stability. The report discusses implications of the Deposit Insurance Fund or the DIF. Increases to the deposit insurance limit would increase the size of the DIF necessary for a given target reserve ratio.

Increasing the size of the DIF must be done through increased assessments on banks. The report then evaluates three options to reform the deposit insurance system. And, the order of the options that we present is just for clarity of discussion and not in order of preference.

The first option which we call limited coverage maintains the current structure in which there is a finite deposit insurance limit. So, that limit could be at the 250,000 dollar limit

we have today but could also be higher. The second option which we call unlimited coverage provides unlimited deposit insurance to all depositors.

The third option which we call targeted coverage allows for different levels of deposit insurance coverage across different types of accounts. And, going to some of the earlier comments, we focus on higher coverage levels for business payment accounts. Each of the options has relative strengths and weaknesses.

However, targeted coverage that focuses on business payment accounts captures many of the financial stability benefits of expanded coverage while mitigating some of the more undesirable consequences. Because each of the options has relative strengths and weaknesses, the report cautions that each of the options should be viewed alongside other policy changes. So, then go a little bit deeper into those three options.

Limited coverage maintains the current system of deposit insurance at the current or perhaps a higher level of coverage. By itself, this option does not address the run risk associated with the high concentrations of uninsured deposits. Increasing the coverage limit by an order of magnitude to millions of dollars would benefit small and medium-sized businesses that hold deposits above the current limit, but it would be insufficient to cover many of the largest uninsured deposit accounts.

Therefore, achieving financial stability under limited coverage would likely require other policy tools such as collateralizing large demandable deposit accounts or limiting their withdrawal capacity. Unlimited coverage in which all deposits are fully covered effectively removes run risk. But, it may have large effects on bank risk taking, deposit insurance assessments on banks, and broader financial market effects.

Insurance backed by the federal government provides a strong deterrent to run risk. However, it would also remove depositor discipline and may induce excessive risk taking by banks. Policy tools such as regulation, supervision, and deposit insurance pricing could be used alongside unlimited coverage to reduce risk taking.

Given the current level of deposits or at least year-end 2022 when we wrote the report, full deposit insurance would increase the size of the DIF needed to achieve any given targeted reserve ratio by about 70 to 80 percent, leading to significantly higher assessments on banks. Targeted coverage provides substantial additional coverage to business payment accounts without extending similar insurance to all deposits. Payment accounts rarely involve the weighing of risk and return that is typical of investment accounts.

Further, losses on business payment

accounts are most likely to spill over to payroll and to other business expenses. Therefore, increased coverage to business payment accounts yields large financial stability benefits relative to its costs on risk taking. However, there are challenges to targeted coverage around establishing a practical definition for accounts that would merit higher coverage and also limiting the ability of depositors or banks to circumvent whatever those distinctions might be.

Extending considerably higher deposit insurance coverage, the business payment accounts may require a significant increase in deposit insurance assessments, though less than if the limit is raised similarly for all accounts. In conclusion, I want to underscore that the deposit insurance system at its current coverage levels is limited in its ability to achieve financial stability objectives due to large concentrations of uninsured deposits. The policy options that we present in the report may be considered to

help reform a deposit insurance system and to meet those objectives.

And last, it's important to note that changes to deposit insurance coverage would require congressional action. However, some of the other policy tools may lie within the rulemaking authority of the banking regulatory agencies. That's it for me, at least for my scripted remarks.

CHAIRMAN GRUENBERG: I would just underscore that we made a completely unreasonable request. Our Division of Insurance and Research to produce a comprehensive report in six weeks or less. That's a bit of an oxymoron by a normal context producing comprehensive anything in a five- or six-week time frame.

But, candidly, I think they managed to do it. If any of you've had the opportunity to take a look at the report, it's really a thoughtful piece of work that places the recent events in the broader context of the long history

of the deposit insurance system in the United States, its evolution, and issues presented by these recent developments. And, I think it's really helped to inform the public discussion around this issue. So, I just wanted really to acknowledge the exceptional job that was done here.

MEMBER RICHARDS: Required reading for our senior staff.

MEMBER MAUST: I just want to commend the team for putting that together. It was an impressive report. I read most of it.

Some of the history, I skipped over. But, what I thought was really nice was the combination of points and counterpoints, the knock of effects and unintended consequences of each of the options. And, a couple I hadn't even considered -- I mean, I haven't even thought through it after reading, it was obvious. But, when you get kind of laser focused in a particular objective, may miss a couple things.

A couple things came to mind. One is optional participation from the standpoint -- I know that's something we had with the TAG Program, also supervisory expectations. That's been something that's been circulating in the industry is if it's unlimited or if it's a significantly expanded deposit base that's covered from an insurance perspective. Is that an equivalent increasingly expanded supervisory oversight or not? Just perception versus reality, just like in the public, there's perception versus reality.

The perception Director Chopra was commenting on relating to consumers thinking that, oh, yeah, this is insured or this is covered. I'll be okay.

It's funny because I was just thinking about that. Our younger son receives payments for his 1099, non-employee compensation. And, it's not immaterial and it sits there until I can sweep it over to his bank account.

And, that concerns me now that that

was brought up. So, when I think about that being expanded to the general public, we live this. We know how deposit insurance works. But, the rest of the United States doesn't.

And, making it as simple as possible because we do have tools. Small businesses, mid-sized businesses, we have reciprocal deposits. We have other ways of covering those, but it's not well understood.

And, so, knowing there's simple coverage particularly backed by the US government is very powerful. As far as a deposit base, we're focusing pretty heavily on the operating accounts of businesses, payment accounts. And, I don't know how thoughts has been given to the deposit base that the insurance premium would be assessed on because that money can move around pretty easily the same day almost.

And, so what's covered, what's not. Obviously, that's going to be a determination for the bank. But, I'm of the sort of bent that just

any non-interest bearing DDA is probably -- whether it's consumer or business.

Probably just takes that off the table and separates the operating funds from the risk-reward decisions that somebody makes when it's more of an investment/savings account. Anyway, I did want to at least bring that up. And, as it relates to consumers, yes, it's not common that consumers exceed the deposit insurance limits.

But, they do have life events. Sometimes we'll leave those funds in for a period of time. So, I think there is a case to be made for consumers to be incorporated in that as well.

MEMBER SHOEMAKER: And, I reiterate your comments. Lillous Ann Shoemaker, Magnolia State Bank, 450 million in assets. And, we do have several customers that it may be on December 31st, they wire in 10 million dollars. And, they significantly impact our balance sheet. And, so that is a concern. But, we also want to keep our business customers that maintain high balances

with us. So, I appreciate the thought that went into these three options.

MEMBER MJARTAN: If I could add too, let me just thank you, Mr. Chairman and your team, for missing a few nights probably of sleep. And, I do think despite the consequences which I don't think were -- I wouldn't call them unintended. I think you were very aware of the risk.

But, I think you did a marvelous job weighing those risks. We had no exposure to SVB directly. But, indirectly, who knows. We know some of our customers had relationships. So, what does that to do ours?

So, I think that was the right call. So, I just want to recognize that. I think that was a tremendous move and very courageous move. So, I applaud that.

Two things I want to just comment on the options. Again, same thing. It was an incredible piece of work that your team pulled together in such short time.

The story that is being told in the media I think is -- you pointed out the numbers may not fully prove out that story. But, what I would say for those of us that serve unique communities or subsets of our community could also say that the numbers also don't tell our story. And, the numbers don't tell the story of our communities.

And, so, my question as we ponder this is truly not just who benefitted but who is paying the price? Who benefitted from this current environment? And, who's going to pay the price.

And Robert shared a wonderful anecdote. I'm not pretending to be half as good of a storyteller as he is. But, I do have several anecdotes at our bank, as a 400 million dollar mission driven bank.

And, I think I mentioned briefly, we did lose several opportunities. We haven't lost any deposits. And, in fact, we're up about 10 percent just since the beginning of the year even

in core deposits.

But, we're paying a huge price for it cost-wise. Our cost of funds is -- it's still low relatively speaking. But, it's multiple what it was last year.

So, the question is who is paying the price. And, to me, who is paying the price, going back to the previous discussion about the lending standards. So, we haven't adjusted our lending standards at all.

We follow the same in the last five, six years. The loans that we've originated since I came to the bank, we've charged off less than 0.08 percent of the loans. Of course, some of them are fairly new.

But also, a third of our loan portfolio is government guarantee. So, we're not necessarily worried about credit risk unless the world falls apart. And, then we'll have bigger problems to worry about anyway.

So, what we are gravely concerned

about is who is going to pay the price. And, I'll give you an example of our most recent loan committee. We had an affordable natural occurring affordable housing project that we could've financed in North Charleston.

And, it was a participation with another bank. And, they would have even allowed us to take the whole loan. It was about a 10 million dollar loan, but it was a construction and rehab.

So, it wasn't pledgeable to the federal home loan bank during the construction period. The rate was about six and a quarter. We would've accepted the rate, had strong guarantors.

Our loan committee voted against a deal even though it was a CDFI LMI area, majority-minority area, great guarantors, great strength, good project, high impact. It hits all the marks for us as a mission driven bank. And, not a bad credit quality at all.

But, the rate and the liquidity killed the deal for us. So, I'm going back to who's going to pay the price for this migration of these deposits. Maybe small.

And, one other quick story and you'll get the sense of why I'm making these points hopefully from it. But, I mentioned we had two bids outstanding for non-profit accounts, large non-profits in South Carolina, very mission aligned. And, at the top of the proposal, I put, all deposits are fully FDIC insured according to, and I linked to IntraFi, the reciprocal deposits because I didn't want to break any FDIC disclosure laws.

So, I said, read more about this here. But we can ensure up 130 million dollars per depositor. Their board met and the feedback I received from the CEO was they were worried about their fiduciary duty.

And, I said, what do you mean fiduciary duty? They just moved the money to a

bank that's not insuring the deposits at fraction of the cost we were willing to pay. So, going back to my point, who is going to pay the price?

So, if we had gotten that amount of money, we probably would've financed the project in North Charleston. Because it would've been core operating account, full relationships. So, there's huge cost, I think, that is not baked into the FDIC insurance to our communities.

And, I don't know how to quantify it. We struggle with it. MDI, CDFI banks always struggle. How do we put a price on the value that we create in our communities? And a lot of -- Magnolia State Bank, a lot of the rural banks and other banks, mutuals, all have significant impact.

But, you can't price that into that and to the true cost that I believe is too big to fail. Even though it may be minor, it may not show up on the big numbers. But, when you translate it to that single mom in North

Charleston that would have had a house and she doesn't.

MEMBER HORTON: I have a question. Good comments by everyone, and thank you so much for your work on this critical issue. Is there any chance that we could combine the third one with the targeted coverage with some increase in the 250,000 dollar limited coverage?

MR. POGACH: So, all of these are congressional decisions. They're not us. The targeted coverage that we focus on doesn't specify a particular level. I mean, doing a full analysis of exactly what any of those numbers would've been given the very great timeline that we were given.

It would've been, I think, a little bit much. So, we don't preclude that as a possibility. I think the account -- 99 percent of all accounts are currently insured at the -- or, not insured, they're below the 250,000 dollar limit which is not exactly the same on the Call

Reports as insured. But, 99 percent of accounts fall below the 250,000 dollar limit.

So, expanding coverage above the 250, who is it that is really important to capture? And, that's why we focused on the business payment accounts because that's where we thought the best benefit might be. But, nothing precludes Congress or from anyone thinking about where there might be benefits when thinking about other groups, for example, life events or other places where it might merit more coverage.

MEMBER HORTON: Yeah, I agree. I mean, I'd love to see something like the TAG Program re-instituted which I see is your targeted coverage. But, I think just considering the last time we raised it from 100 to 250 and inflation and everything else, I guess I'll include that in my comments. I'd like to see both.

MR. MITCHELL: Yeah. As Jon mentioned, certainly they could all be combined.

I think what we tried to do is set aside three bite sized options to think through. They could be used in combination for sure.

On the TAG, just to talk to that because I think that's been mentioned a couple times. And, this kind of works in line with talking about the rate environment when TAG was in place last time, including the -- I'm going to forget -- Reg Q and Reg D have both been eliminated since then. The interest rate environment during the TAG program was effectively zero.

And, now one of the concerns that we've talked about is if you use TAG as defined, given the rate environment change and the actual removal of Reg D and Reg Q that you may not get the same coverage and you may not get the same impact. And, again, people in this environment, are you going to be okay with a non-interest bearing transaction account? Maybe, maybe not. I think what we were trying to think through was

having something that's durable through different interest rate environments because otherwise I'd say the targeted approach is largely intended to get to the same point which is TAG.

MEMBER HORTON: I will say at our bank, we haven't lost any relationships. But, we definitely have seen lots of money going out and primarily into U.S. Treasuries. I mean, I think customers are feeling like that's the safest place now.

And, so they'll leave the core relationship with us. And, then they'll skim it off. And the rates are higher. We can't compete with the perception of no risk or the yields that are being offered.

MR. MITCHELL: And, as you're all acutely aware of, the yield curve is very challenging right now with how steeply inverted it is. And, that, again, makes money market accounts even more -- money market funds even more attractive given the short-term nature,

higher yields. So, we recognize that competition.

MEMBER HORTON: Thank you.

MEMBER PERRY: I think maybe you mentioned that the 250,000 dollars was adequate for -- or seemed to be adequate for individuals. But, let's not forget that a lot of individuals that have more than 250,000 dollars are structuring their deposits to have more than 250,000 dollars in coverage. And, I think I read with the limited coverage possibly taking that away or looking at depositors based on their Social Security number, a different identifier.

If you're going to leave it at 250,000 dollars, don't take that away. We've got to -- I mean, we have plenty of individuals that have more than 250,000 dollars. And, they take comfort even though our bank is a very safe bank, well capitalized. They take a lot of comfort in knowing that their deposits are covered, insured because they structure them to make sure they

are. So, if you're going to take that away, we've got to raise that limit.

MR. MITCHELL: I think -- Jon and Rosalind, correct me. I think when we talked about that, that was if there was some type of significant increase and level, you could look to reducing some of the complexities --

MEMBER PERRY: Okay.

MR. MITCHELL: -- of deposit insurance. So, I think that's the way we framed that it was in conjunction.

MEMBER PERRY: And, that might be helpful for our customers, and also for our personnel because we are constantly training our personnel on this. In fact, when the banks failed, we were making sure that our personnel understood how they could make sure that our customers felt confident in the system. And, like I said, even though we're well capitalized, when the world seems to be falling apart, they don't care.

MEMBER RICHARDS: I think it is a good way though that you can prove that you’re taking care of your customers. And, our customers appreciated us helping them say, we can do it this way and that way. So, I’d hate for you to do away with that too because it’s just a good tool for us to attain and retain good customer base.

One of the questions I would have just real quickly is on the business payment account. We haven’t really touched on that. But, I would want to see more information on how that’s defined because if it’s going to be an account that has X number of transactions, people are going to game the system to get as many accounts as they have covered.

Or is it going to be not paying a rate above a certain amount? What is that going to look like? Because then we’ve got to come up with a coding mechanism to be able to somehow tell you guys how many business payment accounts

we have and how many we don't have of our deposit.

And, what's that going to look like and how's that going to get reported. And, I mean, I like the targeted approach. But, leaves a lot of questions as to what do you mean? What are you talking about?

CHAIRMAN GRUENBERG: I think you're quoting our report, by the way.

(Laughter.)

CHAIRMAN GRUENBERG: See, the report makes that precise point.

MR. POGACH: That is in the report that would seem as the major drawback is having very clear definitions.

MEMBER RICHARDS: I mean, if you make it too easy, then people are going to game it. If you make it too hard, then it's going to be very difficult for us to be able to track how many we have and who we have.

MR. POGACH: And, you could use something like an interest rate as a basis for

defining it. Or there are millions of other ways that you can. From the timeline that we had, we didn’t specify all the different ways that that might be done.

But, if it’s something that’s going to be considered by Congress, that would certainly be something that would have to be worked out. And, to the point on simplification, I think it’s something that we discussed. The simplification is not designed to reduce the overall coverage. It is more to provide clarity and coverage, especially for events like March 2023.

If the system is not clear as to what’s covered and what’s not or consumers aren’t clear on what’s covered and what’s not, that doesn’t benefit, I think, banks or customers in the context of uncertainty. So, the goal is certainly not to -- especially given the way the reports are written to increase the amount of uninsured. That’s not the objective. But, just trying to make it clear to depositors so that

they know what is and what is not.

MEMBER REIGELSBERGER: That's something that we have after March '23 on all of our employees' computers, we made them save the website on the FDIC that where you calculate and you put the names in, the amounts, then you can print it out and you can hand it to your customer. And, they're like just like he said, oh. They can see what -- then if they need to make changes, whether or not you change beneficiaries or whatever you need to do to make it under the 250.

So, that's been a great tool in the last two months especially. So, I want to thank you for that. Our bank has used a lot.

MEMBER BATES: I think, overall, I think simplification is going to be the best because I think most everybody in this room is of a size where we have a lot closer relationship with our borrowers. They're reaching out to us and they know us by name. And, I think that's been very helpful.

And, I do particularly appreciate the fact that you -- in this special assessment, you focused on the fact of the systemically important institutions. I think I don’t get much caught up into the small and the large. But, it is good to distinguish the folks that truly have that systemic advantage and pay that premium forward. If I was systemically important, I wouldn’t mind paying a premium for it.

(Laughter.)

MEMBER BATES: And, it also helped because the two basis points doesn’t sound like a lot when you say it. But, it was a meaningful number on our balance sheet. But, it’s like any insurance.

All our insurance has gone up. Our health insurance has gone up extreme amount. Property, casualty, cyber insurance is going crazy. So, it’s the cost of doing business and it’s a very important insurance to have.

MEMBER MJARTAN: Could you comment

real quick on reciprocal insurance role? Did you consider what role the IntraFis and the Reich & Tang programs, the Stonecastle kind of programs play? Have you all given any consideration to that?

MR. POGACH: We talk about it some in the report.

MS. BENNETT: Certainly, with unlimited deposit insurance, that changes that industry quite a bit. We certainly talked about it in that context, but definitely in the context of the other options as well.

MR. MITCHELL: And, even in the other option, we mentioned that and the beneficiaries and other ways and capacities that there are other ways for individuals to increase insurance. So, we didn't really attack that or direct that specifically. I think there's still some limitations of that for business accounts is kind of our general view.

MEMBER MJARTAN: There are

limitations. And, I guess the question we have some of us use it, we use it heavily, both the transaction ICS program and also the DDM and/or the CRS program. But, is there a role for the FDIC to play and not necessarily promoting that as -- I know these are private sector solutions. But, still, they are helpful and they definitely help with some of our customers. Like I said, we didn’t lose anything because we have a lot of deposits in those programs.

MR. MITCHELL: And, again, like you mentioned, those are private sector solutions. We know and understand they exist in banks to the extent that they want to take advantage of it.

MEMBER HORVAT: Can I ask what is the process from here? I know it’s a mission issue, but where does it go from here?

MR. MITCHELL: I mean, I think at some level what we hope to do and I think that was true, at least the Chairman when he testified. People mentioned to report it. I think it’s

helped inform and start -- maybe not just start -- helped inform the discussion.

CHAIRMAN GRUENBERG: Yeah, I mean, if we're talking about adjusting the coverage, that's really going to be up to the Congress. There is some interest. But, I think of the options presented, I do think this issue of coverage for business payment accounts probably has the most traction in terms of interest and appeal on a bipartisan basis. But, whether there's sufficient interest there to actually get traction for a legislative vehicle, is not clear. And, at least at the moment, Congress has had some other things on its mind --

(Laughter.)

CHAIRMAN GRUENBERG: -- as well. We'll really have to see how that plays out. But, I think in terms of the issues raised by uninsured deposits, it does raise some significant supervisory issues that will be -- that we do have existing authorities and tools to address.

And, it's very much a focus of attention for us now, both on the supervisory end and on the deposit insurance pricing as well. So, that's something we do have authorities we can bring to bear and I think fair to say very focused on that.

MEMBER MJARTAN: One last question. I'm sorry about just going back to the calculation. Is there any flexibility about how the insurance fees are calculated since they're based on total deposits, right? But, there's significant uninsured deposits some banks have versus others. And, then a lot of our deposits, we do either run through the reciprocal or we collateralize. Public funds, we collateralize.

MR. MITCHELL: So, there's two components first to that. So, it's all by rule, and we have a statistical model that calculates the risk again for small banks, for those below 10 billion. It's covering literally over, again, 4,500 banks or so.

Just one point of clarification. In

terms of once that price -- the premium is calculated using the calculator, it's then applied against -- the assessment base is actually largely all liability. It's assets minus tangible equity. So, it actually gets applied against all liabilities, whether they're insured or uninsured or other types of funding mechanisms. So to that extent, banks are paying on their uninsured amounts on the risk base rate.

MEMBER MJARTAN: Is there any appetite for revisiting that? Because a lot of us have other liabilities in addition to deposits. Of course, you have borrowings and then of course you have uninsured. So, technically those would not be covered but we still pay --

MR. MITCHELL: Right. So the --

MEMBER MJARTAN: -- insurance.

MR. MITCHELL: So that actually is a -- that's congressional. That was changed in Dodd-Frank. So, that's under Congress, it was congressionally mandated. It's in the statute.

MEMBER MJARTAN: Okay.

MR. MITCHELL: So, it would have to be changed by Congress.

MEMBER MJARTAN: Thank you.

MS. EBERLEY: All right. Well, thank you very much for the great discussion. I hope that was a helpful overview for you. And thank you to Pat, Jon, Rosalind, Mike, and Kayla for presenting for the last hour on these two topics.

We're going to break for lunch. But before we go upstairs to lunch, I'm going to ask everybody to go downstairs to the lobby. And, we're going to take a group photo. And then we'll move up to the seventh floor for lunch. So, thank you very much. We'll be back at 1:15.

(Whereupon, the above-entitled matter went off the record at 11:56 a.m. and resumed at 1:22 p.m.)

MS. EBERLEY: -- policy discussion with an update -- there it goes -- on interest rate risk, credit risk, and liquidity risks. And

these are three risks that we’ve been talking about together over the past decade. The conversation and concerns have shifted over time with changes in interest rates, yield curves, and bank balance sheets.

And, it’s appeared in our guidance, our supervisory priorities, our supervisory insights, journal articles, annual reports, and quarterly banking profile briefings. In 2013, after an extended period of low interest rates and that was a target range you’ll recall of zero to 25 basis points. We cautioned about the need to manage interest rate risks as banks reached for yield to achieve greater net interest income.

We issued a reminder in 2013 to institutions about the need for careful management of sensitivity to interest rate risk. And, this built on the 2010 interagency guidance. Trey, you mentioned it earlier, about one of the items in the guidance was doing a 400 basis point shock.

And, we included a copy of that 2013 financial institution letter in your packet. It's titled Managing Sensitivity to Market Risk in a Challenging Interest Rate Environment. The guidance covered four kind of things that we wanted to reemphasize or highlight which were the need for board oversight over interest rate risk, having a board policy and limits, having systems from measurement and monitoring of interest rate risk, and having risk mitigation strategies.

We also began talking about this risk in our quarterly banking profile briefings and as we saw institution balance sheets lengthen. The guidance talks about the risks of unrealized losses and longer-term securities that could impact liquidity and capital. It noted that although unrealized losses on securities may not flow through to regulatory capital, under certain circumstances, examiners still considered the amount of unrealized losses in the investment portfolio and institutions exposure to the

possibility of further unrealized losses when qualitatively assessing capital adequacy and liquidity and assigning examination ratings.

It further noted that adverse trends in an institution's gap equity can have negative market perception and liquidity applications. So, we issued that in 2013. Rates didn't start rising till 2015.

But, they did rise gradually from 2015 through the end of 2018, reaching a peak target range of two and a quarter to two and half percent in December of 2018. And, banks managed these changes well over that period. Really, with any negative impacts largely confined to net interest margin compression. And, we issued some other cautions over that same period.

In December of 2015, we issued an interagency statement reminding institutions of the prudent management of commercial real estate as that asset class was undergoing rapid growth. And, we said that we would be focusing our

examination activities on financial institutions' implementation of the prudent principles in the 2006 commercial real estate guidance as well as other applicable guidance relative to identifying, measuring, monitoring, and managing concentration risk and commercial real estate lending activities. And, again, Trey, I think you referenced this, this morning.

And, Anita, I think you alluded to it in your comments as well. We also altered our supervisory strategy for liquidity as we saw a general decline in balance sheet liquidity between 2016 and 2017. This decline led us to first embark on a visitation program and later issue a summer of 2017 Supervisory Insights article about liquidity stress testing and cash flow analysis, including a stress testing template that could be used by institutions.

During 2019, the target range dropped by 75 basis points. And, then in March of 2020, with the onset of the pandemic, the target range

dropped another 75 basis points back to the zero to 25 percent range. The industry experienced record deposit growth in the second and third quarters of 2020, initially held in cash and later invested into high quality securities.

So, I think it's fair to say that as we've been through the interest rate increases over the past 14 months, it's been a little bit different than the experience between 2015 to 2018, with the increases occurring at an unprecedented rate. And, that's what we wanted to talk about to start us off this afternoon, changes in deposit behavior, items to reconsider, and contingency liquidity funding plans, and impacts of rising interest rates on loans and in particular commercial real estate. We'll also discuss the conversations we're having with our examiners, and we'll be interested to hear from you about what you're experiencing and seeing in your markets.

So, joining me is Ryan Billingsley,

Deputy Director for Capital Markets and Accounting Policy. He's going to kick us off with a discussion of asset liability management and liquidity. And, then Rae-Ann Miller, Senior Deputy Director of Supervision Policy, and Tom Lyons, Associate Director for Risk Management Policy are going to discuss commercial real estate. So, Ryan, I'll kick it over to you.

MR. BILLINGSLEY: Great. Thanks, Doreen. It's good to be here. I haven't been in front of this group in quite some time. So, it's good to be back.

So, as Doreen mentioned, I'm going to spend some time talking today about asset liability management, interest rate risk, and liquidity. I don't think any of this will come as a surprise to you. But, I hope it serves as a good reminder in light of the environment we're in.

I think there's a few slides in front of you, a handful of slides. Okay, great. Even

better. So, I'm going to dive in this really quickly. Doreen mentioned kind of the unprecedented level of interest rate increases we've seen. And, I think this chart does a great job of showing that.

Doreen talked about the '15 to '18 sort of gradual increase. And, as you can see, we've been doing something special. So, I think this chart does a good job of showing that.

I think the important thing to note here is that the higher market interest rates have the potential to cause rising deposit costs, which will put pressure on margins, potentially for coming quarters. And, Doreen mentioned also when interest rates were near historic lows prior to the takeoff here on the dotted blue line, some institutions extended their maturities in their bond portfolios to increase yield, which leads me to the next slide which graphs essentially the ten-year treasury in the dotted blue line against unrealized losses on securities portfolios over

that time. Again, the dark blue represents unrealized gains and losses on AFS securities.

The gold or yellow represents unrealized gains and losses on HTM securities. And, you can see, as the Chairman has kind of pointed out in QBP briefings over the last year or so, unrealized losses started escalating early last year when the Fed started increasing interest rates.

It appears based on this that we're heading in a good direction. But, nevertheless, losses are still quite large. So, I think where I want to go from here is to talk about what all this means, right?

I don't want to insinuate that there's poor credit quality in these portfolios. There's not. Most of it is very high quality, government securities, GSE paper, things like that. So, that's not really a concern.

But, I think the important thing to look at is that some of these investments,

because of their unrealized losses may not be able to be sold for liquidity purposes because you have to recognize the loss in that case. And, thus, important losses can lead to reduced access to efficient liquidity and less flexibility to sell those securities. So, these factors need to be thoughtfully considered from a risk management perspective and an on balance sheet liquidity perspective.

There's some potential funding consequences as well. There's some kind of parties could curtail funding commitments if institutions reported low levels of gap equity. That's something that Doreen kind of mentioned in her opening remarks as well.

So, in light of all that, we've encouraged institutions to revisit and update their contingency funding plans in light of the environment we're in, which is probably no surprise. For example, reliance on unstable funding sources and concentrated funding sources

can lead to rapid runoffs when customers are concerned about an institution's condition. And, then we've experienced the portability of visual banking and the social media influences, high yielding investment alternatives that are out there today, both bank and non-bank.

So, we're encouraging our supervised institutions to review their deposit base just to see how they feel about in light of the environment we're in. And, consider potential stressed outflow assumptions that they've made in the past and whether or not they're right for the current environment. And, then encouraging boards and senior management to take a look their asset-liability management frameworks. So, some things to know there are interest rate risk management and monitoring efforts including, like, what you think deposit stability is or what it has been in the past. Is that right for today?

Interest rate risk modeling, so to ensure you are aware of the potential impact on

your capital and earnings when we see rate increases like we've seen. Sufficiency of market liquidity and secondary funding sources, I'll get to some of those in a minute. I think they're important to highlight.

Cash flow analysis, again, on your deposit side and prudently managing growth and earnings in this environment. And, then lastly, I'll spend probably the rest of the time on this. And, that is effective contingency funding plans or CFPs. And, you can show those are up to date in light of the environment we're in.

So, when I think of a CFP that's a robust one, I think of something that's a strong, written plan. They outline key indicators, when you're going to activate the plan, funding strategies that are consistent with the bank's size and risk profile. It's got highly alternative funding sources when stress events are encountered.

So, here, access to the Federal Home

Loan Banks, Federal Reserve Discount Window, and the new bank term funding facility. BTFP, you might hear me call it that. And, we've been encouraging banks to make sure that those secondary funding sources are verified, ensure all the documentation is in place, you've actually tested them out, even if a nominal amount to make sure it worked as you intended it to work.

I would emphasize that during a stress event is not the appropriate time to try to set that up. It can take a matter of days and not hours like you might think it might. So, getting that arranged and operationalized, make sure your staff is aware of how to do that when you need the money is important.

And, then maybe the last thing I'll leave you with is some of these secondary funding sources like the Federal Reserve's Discount Window and the bank term funding program unfortunately have this negative stigma attached

to them. And, I think we intend to tell you that's not how we think about it. We think there are a very good part of a robust and well managed liquidity risk management program.

And, you should use them if you need them. They're there for that purpose. And, the last thing I'll say, we and the Fed and the OCC and the Conference of State Banking Supervisors participated in an ask the regulator a call I think on May 24th. Hopefully, you're aware of that.

If you're not, you can go listen to the recording of that. I think that presentation goes through a lot of the same stuff. More slides, more resources are linked there as well. I think that's just, again, a good reminder for how we're collectively thinking about liquidity, interest rate risk, and ALM in this environment. So, I'll stop there, but I'm happy to take any comments or questions or any reactions to anything I've said.

MS. EBERLEY: Okay. We can move on, unless did you have a comment?

MEMBER MAUST: I was just curious if one of the considerations we've incorporated in each of the -- I'll say sort of CAMELS components. It obviously doesn't include management. But, in each of the areas where there might be calculations from a sensitivity or scenario analysis is the impact on capital, if we were to exercise something. From a CFP perspective -- I assume that's -- and also incorporated into some of the thought processes around having a sound program there.

MR. BILLINGSLEY: Yeah, I think that's right. I think some of the things that I -- I think the thing that I would emphasize is to make sure that all banks have these plans, right? The question is, is it right for today?

Should it be updated? Should some of the ongoing assumptions you've had in the past be challenged given what we've seen in the last

year? So, I think you're thinking about it right. I think I just would emphasize go back and take a look and see is this right for today. And, maybe it's fine. Maybe it needs to be tinkered with. I think that's kind of high level point I would make.

MEMBER MAUST: Thank you. The reason kind of for my question is from an examination perspective also. Is that part of the discussion?

MR. BILLINGSLEY: If you want to take that one.

MS. MILLER: Yeah, I mean, it's part of the discussion, yeah. I think just to emphasize, maybe from experience a little bit more about what he's talking about is you might need to change your contingency funding plan. And, we will be checking to make sure that you've tested it, that it fits today's scenario. And, I can't emphasize enough that waiting until Friday night at 4:30, I'm a little bit scarred.

But, it doesn’t really work.

MEMBER DRENTLAW: I am curious. Anita Drentlaw from New Market Bank in Minnesota. From a non-maturity deposit perspective, it’s very hard to gauge or estimate how much fluctuation is in your non-maturity deposits going in and out.

And, I fear with FedNow coming on, that’s just going to exasperate and stuff. Do you have -- obviously, I know you don’t tell us what to do. But, do you have any recommendations or ideas on how we should be looking at that or how we should maybe change what we’ve looked at in the past?

Because I know if you -- a lot of the models use numbers from decades ago. And, for a bank our size, that’s kind of what we’ve typically done. But, just curious if there’s thoughts.

MR. BILLINGSLEY: Yeah, I mean, I think that’s a great question. So, I think what I would do -- how I think about it is, one, I

would think about it from, like, your deposit structure, your deposit strategy. So, if -- do you have concentrations in certain sectors, certain businesses, if it's more diversified, maybe that's different.

But, I do think that the outflow assumptions you make, sort of the -- we talk about this a lot. What are your core deposits? We talk about whether or not it's the right way to think about it.

But, challenge that assumption. It may be stress what you thought was reasonable. And, see what the output looks like. Do some scenario analysis around, like, just maybe even, like, reverse stress testing a little bit, if you know what I mean.

So, I think there's ways you can do that without trying to come up with the exact right answer, right? Just stress some of the parameters. I think that's how I would think about it rather than pick an output or pick a

stress and say, is this the right stressor? Just take that and maybe add onto it a few other tweaks and see what happens. See if it causes you to have discomfort.

MEMBER RICHARDS: Kind of a follow-up on what Anita was saying. We've looked -- we run a liquidity test every day, a number, and we send it out to senior management. We've been doing that for years.

And, we've recently started looking at our uninsured deposit amount because I know you can get preferred deposits on the Call Report. But, that's not uninsured deposits. You have to adjust and take different things into consideration to get your number.

We've got our number. It's 33 percent. What do I do with that number in relation to my contingency funding plan? In other words, if I know that number equates to 10 million dollars in deposits, do I need to input something into my contingency funding plan for a

certain percentage of uninsured deposits?

I know it's different from bank to bank and there's no, like, okay, if your number is X, then you do Y. But, it's hard for us to know. You say do all this reverse stress testing. That's beyond my pay grade.

You know, but we know our banks. But, I did not know that I was going to lose the amount of deposits that I've lost over the past 12 months. And, how much more am I going to lose before we see a bottom?

And, I guess I'm looking for any sort of assistance that you all could provide to the community bank bankers to say this is what you need to be looking at. This is the range you need to be looking at. We have a contingency funding plan, obviously.

We're borrowers of FHLB. And, they have a complete lien on our whole loan portfolio. So, for me to use the Fed's discount window, the only thing I have is investment so that I can put

up. And, I have four investments in my whole bank.

So, we’re not talking about a whole lot of -- but I might be able to cover what you all would consider to be a prudent amount with our borrowing line at FHLB. So, I might not need the discount window. But, are you all going to say, you haven’t signed up for the discount window. You need to do it just in case.

Well, if I don’t really need it for my number, what my number is. It’s just a whole lot of unknown out there right now. And, so we don’t know what’s going to happen. So, we don’t know how to plan for it.

And, I asked an examiner this. And he said, well Troy, it’s just kind of hard to plan for a bank run because it’s sort of a catastrophic event. So, how do you really plan for that? But you all are going to expect us to make some kind of plan for worst case scenarios I would imagine. And, it’s just there’s not a whole lot of

information out there as to how we do that, if that makes sense.

MR. BILLINGSLEY: No, it does make sense. And, this is super helpful to hear for me. It really is. I think having this conversation here and your feedback on how your bank thinks about this, having four investments, having all of your collateral at a Federal Home Loan Bank. That makes sense.

So, I think it gives us something to think about to take back and see. Maybe there's ways we can tighten things up and help out and provide a little bit better clarity on those sort of situations. That's a fair ask.

MS. MILLER: Can I pipe in, Ryan? Because I'm dying to pipe in. It is really helpful to hear. And, I probably don't have one answer for all of you, and that's what he's getting at.

But, being able to cover. And, it's interesting. I'd love to chat with you after

about your experience in losing deposits and what did that mean. Did it mean that they left or they wanted more money or how did that work? Because that's kind of the two flavors that we're seeing.

And, so I would be more concerned about not what we're looking at but how to get yourselves more prepared and how to cover. And, what the level of coverage is. And, I can tell you from experience that having your securities at the Federal Home Loan Bank is helpful.

But, having a plan that if you need to quickly get them to the Fed, the Federal Home Loan Bank is not the lender of last resort. So, if you need that, setting that up ahead of time is crucial. And, that's a lesson that we learned and we can certainly amplify that to other institutions.

MEMBER RICHARDS: You might be interested to know that our CEO is on the board of FHLB Dallas. And, they were recently told

some information that's from FHLB that FHLB considers themselves to be lender of last resort. And, so what is that going to mean for us going forward?

Are they going to have a rule change that says we've got to sign up for the discount window and borrow from them first before we take out advances? That would be a complete change in the way we've always done it. So, there's some movement happening there that I don't know has been fully vetted yet.

MS. MILLER: Yeah, I hadn't heard that. But, we can certainly look into that.

MEMBER SHOEMAKER: Lillous Shoemaker, Magnolia State Bank. My comment is more of a comment, not necessarily a question. But, we updated our CFP recently. We just finished a state exam on Tuesday.

It always had the elements of communication, who's going to communicate. As bank examiners, you look at us and exam us

retrospective and prospectively. Communication and social media in light of the most recent failures, they did try to communicate.

And, I know you cannot give us specific guidance. But, that is something of concern. You do need to communicate. Traditionally, it's been customers calling us.

We hear this is going on the news, and you comfort them. But, with the widespread quick communication, are we evolving in this industry enough to get out the right message? And, are we getting out the right message quickly enough?

MEMBER DRENTLAW: I don't know if it's helpful. But, I set up the bank term funding. It was a fairly painful process. So, I do echo and appreciate your comments because it took a long time to be completely honest to get the paperwork, put in and stuff. So, I keep trying to tell colleagues and stuff the same thing. And, I do appreciate your comments about it because I wish they could streamline that process a little

more.

MS. EBERLEY: Thanks. We'll move on to commercial real estate, and we can come back to more general conversation at the end.

MS. MILLER: Sure. Would you like me to take the commercial real estate? So yeah, I'm going to talk a little bit about commercial real estate priorities. I know you had your presentation this morning about some macro findings and what's going on with the industry. And, hopefully, that was interesting to you.

Hopefully, nothing is a super surprise to you. We've been looking at commercial real estate since there was commercial real estate and since there were examiners. But, certainly, the crisis of the '80s and the '90s and the legislation and regulations that emanated from that, in particular, Part 364 of our rules and regs which are the safety and soundness standards and 365 which set forth our real estate lending standards.

That's sort of, like, our baseline that we work off of in our examination priorities. And, then just before the previous crisis, it was December 2006. I believe we finalized a pretty significant piece of supervisory guidance on CRE where we talk about heightened monitoring and not thresholds.

But, we described some thresholds and, excuse me, some criteria where it's prudent to increase your attention to commercial real estate. And, so right before the previous crisis, we issued that. And, we've really been examining for commercial real estate.

I can't say to that guide, but it's been very helpful to us. And, we supplemented that with an advisory in 2015. And, in 2015, Doreen just went over the interest rate history.

We were in a low for a long -- and we saw building exposures in commercial real estate. And, at that time, we saw kind of meek provisioning and building of those exposures

using wholesale funding. So, we issued an advisory.

And, at that time, at the FDIC and the other agencies, we engaged in what I would call sort of a -- like, a perpetual horizontal review. So, maybe some of you have been subject to this is when we have concentrated institutions. We do enhanced examination procedures and use that to kind of come away with observations about underwriting and other risk management practices.

And, last summer in August, we published an SIJ. If you have a chance to go back and look at that, it talks about some of our findings -- weaknesses we observed and stress testing and provisioning. And, we also talk about our supervisory priorities.

And, I want to read because I was just going back and looking and saying, I hope I said this in our exam -- in our article. And, of course, I didn't put it in here. So, we talk about supervisory approach to CRE.

In particular, examiners will be testing numerous CRE credits, credits within stress subcategories and geographies, and credits with payments vulnerable to rising rates and rising costs. So, that was in August of 2022. And, so that's probably what you've been seeing examiners doing.

This is still -- pandemic is still with us when we wrote this article, although it was certainly waning. But, we say again an increase in exposures with a flush of -- influx of cash related to the stimulus programs. And, frankly in a lot of the sectors, housing in particular, there was probably kind of a hangover from the last crisis of demand.

So, we saw a lot of activity during the pandemic in CRE. If you had asked me when I was sitting my kitchen those few days what would happen, I would've thought we would've had some disruption prior to this. So, we've been thinking about this for a while.

We issued some general guidance about workouts and working with your borrowers right as the pandemic hit. And, then Tom is going to talk about some proposed CRE guidance that we intended to be longer term that would update some workout guidance that we issued in 2009. But, whether or not we update this article, I'm thinking about it.

But, the priorities really do remain the same in the rest of 2023 into 2024. You heard about office. We're certainly concerned about office space and some of the trends that we're seeing, particularly in our gateway cities about occupancy levels, about the amount of loans that are coming due, people giving up space, people wanting less space, and at the same time demanding basically cuts in rent.

So, at the same time, you've got these loans coming due. You've got smaller rent rolls. And, so that's going to impact the value of those properties. It's going to impact the cash flow

of those properties.

And, again, like I mentioned, certainly the gateway cities are most affected. We were super focused on retail and hotel when the pandemic hit. And, certainly some of those have recovered.

Retail was a long-term trend. And we've actually seen a little boost in retail. You might've heard today. Retail in office buildings is sort of a subcategory that's in our cities again having a problem.

You can just walk around here and see some of the vacancies in our office buildings here. So, office, you can expect to see sampled pretty goodly here in this next exam cycle. Acquisition, development, and construction, we do have -- as I mentioned, it was sort of a pent-up demand.

We had a long period where there was very little ADC done. After the last crisis, there was a lot to absorb, and people got burned

pretty badly. That was the most troubling category.

But, we definitely saw an uptick during the pandemic, and now we have some banks with significant balances. We will be sampling those. Obviously, we always do.

But, depending on the phase, if we have projects that were started, sort of in this rising interest rate environment, we're certainly going to be focusing on those. Tract development was another. In certain areas of the country when we saw migration patterns, people moving out of California, people moving out of other heavily populated areas to less populated areas.

We saw boom in building. And, certainly looking at those areas so far, they've held up quite well. I mean, demand has still been very high for housing.

But, with affordability issues with rates rising and looking like they're going to stay up at least for a while, affordability

issues on those houses have certainly declined. So, we always are focused on ADC. But, particularly, that sub-segment has got me -- I can't say concerned, but certainly got our attention.

And, then another category that I'm not sure if you guys talked about this morning, I didn't have a chance to look at the presentation. I've heard it before. But, the multi-family segment is typically very strong.

Then we say, we can have a crisis. But, people need places to live. But, in our cities again, we've seen some softness in affordability. Vacancy rates have been going up. Delinquency rates have been going up.

It's just people have a hard time meeting ends meet with inflation and just are more likely to get behind on their rents. So, another category that we're definitely looking at is multi-family. So, I think that's kind of what we're seeing. I talked a little bit about

historical policies and what our supervisory processes are. I wanted to get Tom to talk a little bit about policy matters.

MR. LYONS: If I don't break it first.

MS. MILLER: I did that.

MR. LYONS: Sorry about that. No worries. All right. So, thanks, Rae-Ann. So, we do a lot of looking back in history in policy and all those things. What goes around, comes around.

Mr. Bock and I were talking a little bit about that just before we started the session. So, CRE is a classic with that. So, we only have the one slide for CRE workout guidance. It's still proposed.

But, we think we're getting very close. We thought with all the rest that we were talking about today, we thought this is a really good opportunity to kind of talk a little bit about what we've been doing with that proposal. So, as Rae-Ann had mentioned back in October 30

of 2009, the FFIEC agencies had issued and adopted a policy statement on prudent commercial real estate workouts as a useful resource for both agency staff and the institutions in understanding risk management and accounting practices for CRE loan workouts.

So, we’ve been seeing that over 90 percent of banks engaged in CRE lending and CRE loans are the largest loan portfolio type on nearly half the banks that are out there. The dollar volumes are at historic highs. Nearly 30 percent of banks have concentrations exceeding 30 percent of capital plus loan loss reserves, and acquisition and development construction loans that exceed 100 percent.

And, so those are those areas that we’re focused on in that 2006 guidance as really areas to kind of focus in on and pay more attention to because the exposure is there. More risk when things go -- or the economic starts souring. In 2020, the COVID-19 pandemic led to

stress across several property types, as Rae-Ann was mentioning, including hospitality, retail, office, and entertainment sectors.

The office sector remains particularly vulnerable. Some borrowers may have difficulty refinancing given the structural decline in office demand. I know it's one of the things we noticed quite a bit when we're walking around town here is since coming back into the office, there's a lot less people walking around even here. It's quite noticeable.

In the 2021 shared national credit review reflected a higher classified rate for CRE as well as increasing levels for CRE loans listed for special mention. While the 2022 review identified some improvement within the pandemic impacted industries such as CRE. The report made note that the results do not reflect the full impact of increasing interest rates and softening economy -- economic conditions that started to impact borrowers in the second half of 2022.

So, regardless of the CRE sector, CRE borrowers' abilities to manage through the period of softer economic conditions including supply chain imbalances, labor challenges, geopolitical attentions, inflation, rising rates will impact the level and direction of risk in 2023 and beyond. So, to assist financial institutions given these challenges and risks facing CRE lending, the agencies in consultation with the state bank and credit union regulators decided that this was a good time for us to go back and update and expand the 2009 statement. The timing was right.

And, so we issued in third quarter last year for public comment the updated proposal. So, the proposed statement discusses the importance of working constructively with CRE borrowers who are experiencing difficulties -- financial difficulties. And, it would be appropriate for all supervised institutions engaged in CRE lending.

The agencies recognize that the prudent CRE loan accommodations and workouts are often in the best interest of both the institution and the borrower. Accordingly, the proposed statement reaffirmed the key principles that were in the 2009 statement such as financial institutions that implement prudent CRE loan workout arrangements, after performing a comprehensive review of borrowers' financial condition, will not be subject to criticism for engaging in these efforts, even if these arrangements result in modified loans that have weaknesses that result in adverse classification.

And, another key principle is modified loans to borrowers who have the ability to repay their debts according to reasonably established terms will not be subject to adverse classification solely because the value of the underlying collateral has declined to an amount that would be less than the loan balance. So, the proposed statement adds a new section on

short-term accommodations. Short-term and less complex CRE accommodations are a tool that can be used before a loan requires a longer term or more complex workout scenario.

We built in a lot of the messages that we had in some of the pandemic accommodation guidance that we had issued. The proposed statement reflects changes in the GAAP accounting rules that have happened since 2009. There's been a lot of those.

And, it includes those in relation to the current expected credit losses. So, that's been built in. The proposed statement also updates the original six examples that we have in there for showing different scenarios of how to treat them. And, it adds three new examples for multi-family, acquisition, development, and construction for residential, and income producing for hotels.

So, those were three added examples with various scenarios of how to think about

those from a classification and accounting treatment. So, we received 22 unique comments on the proposal. We're in the process of revising based on industry feedback that we received.

And, we're hopeful to have that out in the near term. But, anything with interagency whenever I'm asked to try to predict those things, I can never do it. But, what we're wanting to do is just get that on your radar screen, know that it's coming. Hopefully, it's coming very, very soon. But, even the stuff that's in the 2009, all those principles are really very important.

MS. EBERLEY: So, that is our presentation on interest rate risk, liquidity, and commercial real estate, the challenges of managing in a rising interest rate environment. I'm happy to open it up for additional discussion and any feedback you have for us on things that we can do that can be helpful to you. So, we heard some good comments already relative to

contingency funding plans and some things that would be helpful relative to interest rate risk management. So, any other feedback that you have for us as we update existing guidance to kind of reflect the current situation would be most helpful and welcome.

MEMBER HUANG: I'm just personally -- that proposed statement, pretty excited for it to come out. During the pandemic, the FDIC's workouts, I think, we had meetings actually with the MDI Subcommittee at the beginning of the pandemic where we were all predicting that there would be quite a lot of non-accruals on our portfolio. And, luckily, that hasn't happened.

I think the workouts really worked as intended for us. In New York, we've been stress testing our office vacancies, hospitality. We also have branches in Florida. And, so hospitality was quite a large portion of our portfolio at one point.

Same with offices, multi-family. And,

so we were running all kinds of doomsday stress testing for the last two years. And, luckily, knock on wood, hasn't materialized yet.

But, having the proposed statement would allow us some flexibility without having to -- how do I say -- for the lack of a better word, TDR, right? So, we are CRE-heavy, but we're also cognizant of certain things like construction softening because of delays in construction and materials.

Industrial for in our area has become two to three times what it was pre-pandemic. Those levels can't stay there. So, we're very cognizant of that. Offices, we've started to step away from that in the last couple of years.

New York, we recognize that. Most of the leases are on a lag five, ten years, and they're all coming due soon. Personally, from my apartment, I can look into an office building that's about 50 stories tall, and it's probably half empty still. And, I don't think it'll ever

get full again. So, I'm looking forward to that proposed statement.

MEMBER HORVAT: I would have to say I agree with Warren completely. We're looking forward to it as well. We do a lot of CRE lending. I think we all learned a lot.

You mentioned the '80s and '90s. I know I certainly learned a lot from the real estate crisis, and I think you guys have as well. And, I think the way you handled the workouts during the pandemic, we also had an overhang of hospitality loans. And, knock on wood, they've all come through pretty well.

But, we gave them the time to do that. And, the FDIC certainly gave us the time to do that as well. So, I am just curious, though. You mentioned multi-family and the softening. Is that national issue, or do you see it in pockets?

MS. MILLER: We definitely see it in pockets. It's sort of our gateway cities. And, definitely in like the C and B space where people

just have a hard time making ends meet.

And, then the A, there's probably more A being built than can be absorbed. So, sometimes people from A will see a good deal in B and slide over. I don't know if you have the same experience or if things are holding up well.

MEMBER HORVAT: Things are holding up really well in New Orleans.

MS. MILLER: That's great, yeah.

MEMBER HORVAT: At least from --

MS. MILLER: Yeah. I mean, there's a reason why the 2006 kind of calls out multi-family as maybe not as risky as some of the other segments because that's historically been the case. But we are definitely seeing softness in some of our cities.

MEMBER BATES: We're a CRE bank also. Of course, we don't have to deal with the office space. But, we are fairly heavy in hospitality end and some multi-family.

But, we've seen more multi-family

going to non-recourse. So, we haven't been able to hold the really -- the big stuff. So, most of the stuff we hold is smaller.

I would be interested in your thoughts because my feeling is that appraisal should already be being impacted. We've not see cap rates go up to the level I thought they would and impact the values the way I thought they would have by now. I didn't know if you were seeing that in other areas. But our area, things are still fairly similar.

MS. MILLER: Cap rates don't want to go up, do they? It is definitely lagging. But, it's definitely something that examiners are looking at.

And, banks need to have policies about when to reappraise. And, obviously, we have our regulations about when reappraisals are necessary. So, I think that issue will be forced at some point as these portfolios get repriced.

But, it definitely behooves folks that

with portfolios where, hey, this hasn't moved, to do your own work on that and make sure that things are priced appropriately. And, that makes sense for your stress testing as well. In our article last year, what we saw was lagging cap rates and lagging updated rent rolls and things like that.

Examiners and bankers, there was some uncertainty during the pandemic. But, as things have settled down now, those updated metrics should be in place as you're doing your stress testing. That was a really kind of notable thing in our findings last year, just not having updated metrics. A lot of overlays too because we didn't really know what the pandemic was going to bring. But, now that things have settled down, I think banks should really start to update those.

MEMBER BATES: We're finding that disconnect in loan to value and debt service coverage. So that tends to be where --

MS. MILLER: Yeah, that should tell

you.

MEMBER BATES: -- we bump heads because we're, like, we can do 60 percent. We can't do 75 because we need the 125 or the 130.

MS. MILLER: Yeah.

MEMBER BATES: And, so that's caused a lot of tension in the market.

MS. MILLER: And, how can it be 60 if the debt service coverage isn't there, right? So --

MEMBER BATES: Right.

MS. MILLER: We have late breaking news too. So, Tom is going to talk a little bit about something that we just issued today. We issued an update to our manual on our instructions on special mention designations. And, we did this to basically update our instructions to our examiners.

The definition of special mention stays the same. But, we recognize that we were a little bit different than the other agencies.

And, kind of out of step, with more modern sort of credit risk rating systems. So, Tom, we'll turn it over to you.

MR. LYONS: Okay. Thanks, Rae-Ann. So, exam instructions fall into my bailiwick as well. So, we've got a whole lot, a host of different things here. So, special mention, as Rae-Ann had mentioned, we differed a little bit in some of our instructions.

The definition is the same with the Fed and the OCC. Back in 1993, when there's an interagency statement that was issued on special mention, our instructions really related to what was management -- correctable by management whereas the Fed and the OCC got more into some of the economic factors that could be out there as well. But, the definition, just to remind everybody, is a special mention asset, has potential weaknesses that deserve management's close attention.

If left uncorrected, these potential

weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. So, with our instructions, we're really focused in on those management correctable whereas the Fed and the OCC were a little bit more broad and they would consider other factors as well.

And, so what that resulted in is -- you didn't see all that much special mention in FDIC's reports. And, there'd be more so with the Fed and the OCC. So, one of the reasons that we did that was there was some concern way back in '93 that examiners might overuse special mention as opposed to adversely classifying or passing loans during their loan review.

But, there's been a lot of work with credit risk -- excuse me, credit systems and

rating systems. And, sophistication has come a long way since '93. And, some of our concerns in that space are no longer there.

So, what we did want to do so that there's supervisory parity across the board is to get our instructions in line with the Fed and the OCC. So, we've updated our manual instructions for our examiners. We didn't expect it to get done, but it did get done and quickly.

So, that just happened today to get that out. So, we've updated our instructions. We're going to be training our examiners in how to think about that. But, given the instructions, you might see that there's going to be a little bit more special mention where you might not have seen that in the past.

And, some of that is going to relate to -- our examiners focus in on your credit risk rating systems, right? And, if we're in agreement with your credit risk rating system and it has a definition that aligns with the

interagency statement, we're fine with how the bank is rating their loans with a special mention. We're going to be putting that into the report.

So, you'll see that reflected there. If the bank does not have a rating system, a rating that equates to that, well, then what you'll see in the report is going to be special mention as our examiners are seeing that and defining that, just like with a classification. It will be applying that and you'll be seeing that in the report of exam.

So, essentially, that's in a nutshell that we've just updated that. And, you may be noticing that, and you may have some questions for examiners. And, we're going to be prepping our examiners for those conversations.

MS. EBERLEY: Okay. Well, thank you, Rae-Ann, Ryan, and Tom. Next, I'm going to be joined by Martin Henning and Chris Finnegan. Martin is the Deputy Director of Operational Risk

in the Division of Risk Management Supervision, and Chris is the Senior Deputy Director of Compliance and CRA Examinations in the Division of Depositor and Consumer Protection.

We're going to start with Martin who's going to cover ransomware controls and cybersecurity resources. And, Chris is going to discuss guidance on charging overdraft fees for authorized positive settle negative transactions. Martin?

MR. HENNING: Great. Thanks, Doreen. Glad I don't have to talk about cybersecurity as the last thing you hear today. I want to talk about two things, ransomware attacks.

Again, some of you have been here for a while, but some of you are new. So those who've been here for a while have heard some of this before. I just want to hit the highlights for those of you that are new about some of the work we did with regard to ransomware attacks and understanding them.

And, secondly, provide you some information about how or what we're doing to help you defend and recover if there is an incident. So, if we could go to, yeah, that background slide. Some of you have heard me brief before.

But, what we did a couple of years ago and I wanted to highlight again as really a horizontal review of attacks at FDIC supervised banks. We looked at a period of two years and really dug down deep, talked to the bankers that dealt with these situations after the fact, looked at forensic reports.

Really tried to understand deeper than we would just in a regular IT examination. And, there were a couple reasons why we wanted to do that at least. Are there defense mechanisms working that aren't widely known?

Is there something new out there that is making a difference for banks that are able to really defend well and yawn and pull a server back up and no impact on customers, that sort of

thing? So, that was one of the things we wondered. Is there something new out there that other bankers don't know about?

The second reason we did it is we wanted to find out are there any examination changes warranted to help banks identify weaknesses? Always looking to make our IT portion of the exam better. Ransomware is a big threat.

It is not a good day when we get an email from a banker from their Gmail account saying that we're down. And, that gets our attention. So, is there anything we can be doing better to help?

So, again, I said -- looked at two years worth of attacks on FDIC supervised banks. We categorize them into three categories, high, medium, and low. The high attacks were those where a ransom was paid or there was a loss of services or data or there were significant remediation costs and time involved.

A moderate, a medium attack was one where there was internal movement. So, the attacker got into the bank's network and was able to move laterally. There was persistence. The evidence was that the attacker was there for a long time. But, there was no loss of services or data. And, there wasn't significant remediation. So, that was a moderate.

And, a low were attacks stopped before there was any significant or cost or impact which I'd like to pause there. Cybersecurity is part of my work. And, the headlines and the ones that I focus on are the ones that were big impacts, of course.

But, there are a lot of banks that are attacked that brush it off. It gets into a server on the perimeter. Their IT folks stop it. They shut the server down very, very quickly, rebuild it from backups, and no customer ever knew anything happened.

So, what we've found, those are

categorizations. What did we find? There were 36 up here on the second bullet -- sub-bullet, 36 ransomware attacks of interest.

Four of those were at service providers, didn’t get over to the bank at all. And, then 32 were attacks against banks directly. So, focusing in on that count of 32, 18 of those 32, or 56 percent, were in the high category.

Fifty-six percent were in that high category. It’s a lot. Four, or 13 percent, were moderate, and nine, or 28 percent, were low. There were nine banks out of 32 that shrugged and went on.

In five of the attacks categorized as high, the bank paid a ransom. And, those ransoms totaled thirteen million two hundred dollars total, in aggregate. So, if we could go to the next slide.

In the nine low impact attacks, where the banks successfully defended, these were the controls that made a difference in containing the

attack. These are pretty technical. But, hopefully as you look at this list, there's one or two controls here that look familiar to you.

I remember back in the day when multi-factor authentication was viewed as a pain. Even customers, I think, might view -- the knowledge of multi-factor authentication to get access to their money is a very good thing today. Relative to the first reason why we horizontally reviewed ransomware attacks, none of these controls are new or novel.

They're all widely known, widely available, widely publicized. For your IT folks, there's nothing new under the sun here. So, let's move to the next slide.

Second reason why we did it, are there adjustments we can make to IT examinations? And, what we did is created technical examination aids that guide or examiners deeper in those nine control areas from the previous slide. So, an IT exam is a relatively small portion of the safety

and soundness exam.

We're not going generally deep in an area unless there's a reason to -- there's a risk reason to. But, in these nine areas, there's definitely a potential reason to go deeper. We field tested these examination aids.

And, maybe I should back up and just say the examination aid is really designed to help the examiner go deeper to ask better questions in these nine control areas and focus on those. So, we field tested these technical examination aids in eleven banks in the fourth quarter of last year. We used them in banks of all complexity levels, community banks, bigger banks.

We tested them in various IT rating categories of ones, twos, and threes. Banks we think are doing a great job, medium job, maybe needs some improvement in IT. Really with the idea of coming to a conclusion about how practical examiners using technical examination

aids like this would be.

So, eleven banks. We're making some refinements to the aids for examiners right now. And, this year, we intend to use them in 22 community bank exams and actually in all of our large bank exams this year. And, in terms of the 22 that we're choosing, again, risk focused institutions where there's some indication that there could be greater risk.

Again, a previous IT exam rating might be a good reason to spend some time deeper in these areas. So, that's our ransomware horizontal review, why we did it, what we found, what we're doing about it. I'll move down to what we're maybe providing to you, not only on ransomware and that threat, but any cybersecurity threat.

There's an FFIEC Cybersecurity Resource Guide for Financial Institutions that we published first in 2018. And, the FFIEC members came together and updated that recently. I

highlight that there are resources in this guide that not only help you defend but also help you exercise, even that second bullet up there.

Perform exercises to test cybersecurity readiness. And, the FDIC has got some vignettes on our website still that you can use in internal testing. And, thinking about the liquidity discussion earlier, same thing here.

You really need to -- one thing that really makes a difference is banks are prepared if their defenses aren't successful. Things as basic as could your branches run manually for a few days. And, if your answer to that is yes, how do you know?

Have you actually tried that? Have you actually practiced that? Another thing you don't want to be doing when it's absolutely necessary to avoid a tweet or something. You want to be confident that you can do that ahead of time. If we could turn to the next slide.

We put this out in October of last

year. There's a lot of information about ransomware and other resources. We've highlighted some of them here, and that's really one of the focuses of the update to this guide.

I'd focus on this slide on the last one, the fourth bullet there, Conference of State Bank Supervisors. And, they did this with the U.S. Secret Service and the Bankers Electronic Crimes Task Force. It's a ransomware self-assessment tool.

It's really something that you could use I think at the board level. It's very simple. There's 16 questions. They're very basic things.

It's not technical. It's something that you could -- if you were concerned in this area, you could have the team use and then present at the board level. If we could go to the next slide.

Another thing I'd like to highlight in the guide that's there in this revamp is a service available from CISA, the Cybersecurity and

Infrastructure Security Agency. It's called cyber hygiene scanning. Especially Treasury, but all of the agencies and again in the FFIEC guide have emphasized the availability of this free resource.

And, what it is, is CISA going and scanning the perimeter of your IT environment, the things that touch the internet that they can scan just automatically to see how it looks. For example, how updated those servers are. They've got the latest version of the software.

A lot of your IT folks will argue that's only as good as far as it goes. There's a reason why that server isn't updated even though this CISA scan or there's commercial services available too that identified an issue. But, I think it is a good starting point.

And, CISA uses that information from those scans to analyze and then publish back out to the public what they're seeing in terms of weaknesses and what needs to be done about those,

what those weaknesses could result in. So, we've seen a big uptick in banks taking advantage of this cyber hygiene. Again, there's no cost to the bank.

So, something, again, that you'll see perhaps new in the guide that we put out. And, I think we can go to the next slide. We share this guide in a financial institution letter.

The FFIEC has got a cybersecurity awareness web page. The FDIC does too. I love the name of CISA's website with regard to ransomware resources. It's called StopRansomware.gov, easy one to remember. But, those are areas I thought I might cover that might be helpful to you. Happy to take any comments, questions.

MEMBER MAUST: Thank you, Martin, for that insight. The RSAP is -- I know it was published a couple years ago. There's a -- or a year and a half ago. There's a new version, I think, that I can't remember if it's this month

or next month we're expecting it to come out. Maybe a couple revisions in that.

It was intended to be blocking attack and very easy to achieve for banks to understand and fill out. I had a question, though, in addition to that, more comprehensive cybersecurity and information technology, infrastructure assessment tool, the old CAT. I know it's been around for a long time and in my perspective a fantastic comprehensive tool for us to use.

As an industry, completely voluntary, but really easy to then in a consolidated format present to a board to explain, here's our inherent risk. Here are the mitigating controls that we have in place in order to make sure that we're compensated for that risk. Is there -- what's the FDIC's thoughts around updating that?

I know it's not intended to be, I don't believe, an interagency effort going forward. But, certainly being involved and maybe

providing input. If industry were to take that up or if maybe CSBS or others were to kind of sponsor the effort, but with industry participation. Is the FDIC interested in providing input there? What are the thoughts around CAT and its use going forward specifically from an updated standpoint?

MR. HENNING: Yeah. Well, thanks for the question. And, maybe the first thing to highlight for everybody is we still do feel like a consistent cybersecurity -- comprehensive cybersecurity assessment like that is really important. Something that the IT folks are saying some year in the budget cycle we're good.

I'd really question that. And, those assessments are something they can get at where the next improvement is necessary. So, they're really important still.

I think the second thing that comes to my mind is when the FFIEC members including the FDIC created it, there wasn't much around. There

was really a need for it. The members did an assessment of their own before they put that out.

It was about the same time that the NIST -- the cybersecurity framework was coming out. Now there are quite a few of those. And so, one that comes to mind that's industry sponsored started off with the Financial Services Sector Coordinating Council is the -- they call it the profile. It was called a financial profile.

But, the Cyber Risk Institute now manages something that's similar. And, it's very good, and they come to us and ask us about its quality. And, is hitting on all of the things we're concerned about?

So, that's the second thing I would say. But, it does leave -- I think the concern I would have and maybe underneath the surface of your question is for a community back that's been using the FFIEC cybersecurity assessment tool, where do they go from here? And, we don't have

a -- I don’t have an answer for that question today, but that’s definitely something that’s on our mind.

Personally, I want to do things other people aren’t doing. Nobody else is examining. It’s us and states. And, I want those to be great.

And, if there are other great cybersecurity assessments out there and it’s relatively easy for a community bank to move to them from the CAT, that could be a good solution. Or, like you say, potentially another organization taking on the update of it, as you probably know, NIST with their big assessment that’s getting ready to publish a pretty big update to that. And, that would be an important thing to look at in terms of the current state of assessing yourself and knowing how prepared you are.

MEMBER MAUST: Thank you. Just one thing I’d like to add with respect to how the CAT

differentiates from, say, NIST or the sector profile, the sector profile I think is very helpful on the kind of equivalence of the maturity levels in a CAT. So, what are those mitigating controls?

It's focused for which ones should you use or have in place. It's focused on sector impact. And, what I would like to know from a community bank is, what is my inherent risk as an organization?

And, the sector profile doesn't have that component. So that might be what we suggest we focus on, CSBS and others, in coming up with an update for the CAT and maybe incorporating what's already there in, say, either NIST or sector profile since sector profile already mapped to pretty much everything that exists today on the mitigating control side. So, I think it still leaves a hole on the assessment piece which, I mean, obviously critically important. So, thank you very much for that input.

MS. EBERLEY: Very helpful comment. Thank you. Okay. Chris, you're up.

MR. FINNEGAN: Well, hello, everybody. Good to be back with you. And, several of you all I've had conversations with on a variety of issues since the last time we met. So, it's good to see everything in person.

And, before I get started on authorized positive settle negative issue that I want to give you kind of a highlight today, I wanted to highlight and promote our -- since we met last, our Consumer Compliance Supervisory Highlights that we do yearly. This came out at the end of March. And, it's a pretty quick read, and it talks about a lot of the issues that we've identified in the previous year.

And, it's pretty high level. It gives you good insights on what we're identifying from a consumer compliance perspective, and also a little bit of insight as well on what's coming up. So, this is good.

You can sign up for it at our FDIC.gov website. And, it's good in there. Some of the information in there that I really wanted to point out is that our banks are doing really well with the compliance management system.

I think it's 98, 99 percent are rated 1 or 2 for consumer compliance. So, doing a really good job with managing your consumer compliance risks. But, today, I did want to talk about one issue that has -- it's not new in that it's been out there for a few years.

And, it's dealing with a particular overdraft issue. And, I may have mentioned this when I met with you all last time. But, we referred to it as the authorize positive settle negative.

And, so when you hear APSN, that's what that stands for. And, a few weeks ago, back at the end of April, we issued a FIL, a financial institution letter, out to the industry dealing with this particular issue. Again, because we

had gotten feedback that even though we have highlighted this or put it in our highlights and this particular issue was in our June 2019 supervisory highlights that some issues, we need to put out a FIL on to get more granularity into what the issue it.

And, so we did put out this FIL in April. And, so what it is, it was just reminding banks of the consumer compliance risk associating with assessing overdraft fees on a transaction that was authorized against a positive balance, but later settled against a negative balance. So, when we talk about APSN, that's what we're talking about.

So, I'm going to go a little bit about the background of what this is, the risks there, some of the mitigation practices that you can do. And, then we have several resources that I wanted to point out as well. So, a little bit about the background, we have identified banks that assess overdraft fees on debit card

transactions that authorize when a customer's available balance is positive, but later posts to the customer's account when their balance is negative.

In this scenario, a customer's account has sufficient available balance to cover a debit card transaction when the transaction is authorized. But, due to one or more intervening transactions, has an insufficient balance to cover the transaction at the time it settles. So, that's basically the issue that we're talking about.

I did want to point out because I did say available balance a few times there. As I pointed out in the slide here, this can happen both on available and ledger balance. So, depending on how you have it set up, how you charge your overdraft or set your overdrafts, they can actually happen on either/or.

It's less pronounced in the ledger balance. But, it can actually happen with a

ledger balance as well. But, it's more pronounced, like I said, on the available balance. But, wanted to make sure we point out that it can happen on the ledger balance as well.

And, basically when we see this, in the instances that this has come up, we consider this to be an unfair practice. And, I'm going to go over what that means. And, I know that's never an easy thing to hear when we talk about deception or unfairness.

But, this particular practice, we have seen it being an unfair practice. And, I'm going to go over what that means next. So, when we talk about different things, when I talk about an unfair or deceptive practice, it is dealing with Section 5 of the Federal Trade Commission Act.

And, also, we have it under the Dodd-Frank Act, which is the UDAP which adds the abusive factor in there. But, we have the ability under both of those to be able to cite violations. This particular practice as I said when it

happens has come out as unfair.

And, so if you look on the right part of the slide, that's what it means. It's an unanticipated, unavoidable overdraft that may cause substantial injury to consumers. And, we believe that is because of the fees.

It's not reasonably avoidable because the consumer does not have the ability to control the payment systems or overdraft processing systems. And, they're not outweighed by any countervailing benefits to the consumers or competition. So, when I talk about unfairness, and this is a standard that the different agencies use when we talk about under Section 5 of the FTC. Okay. All right.

And, this is -- we're going to get to the heart of the matter. What we would like and what we recommend that banks should do is several things to mitigate this because a lot of times when we go in to the banks, the banks don't know if this is happening or not. And, so we're

definitely recommending that all our institutions review their overdraft practices that deals with this to see if it's happening or not as part of your system.

And, like I say, a lot of times, the bank doesn't realize this is going on. And, so we're trying to get out more and more information about this to make sure banks are looking at it, seeing what your system has, and then correcting it when necessary. As always, we recommend that you review your disclosures and account agreements and make sure they reflect actually what's happening at the institution so that there's no deception type of activity.

And, that's on anything, whether it's APSN or any other type of fee. You always want to make sure that your disclosures and your account agreements actually reflect what the bank is doing and what you want it to do at your institution. Sometimes that pops up as well where that doesn't realize exactly how the system

is set up and the disclosures don't match up.

So, you got to be real careful with that. And, a lot of times, you have your core providers and you want to make sure that you're looking at your system to see how it is set up. And, a lot of times, these systems come in and the banks, you can adjust them and do different things.

So, you want to, again, have it do what you're wanting it to do. And, so when we recommend on this third party is to go in there and to see is this happening at your bank where these debit card transactions do come in. And, there may be a positive balance when it's authorized. But, when it actually comes in and clears, it hits on a negative balance and that overdraft fee gets charged.

I mean, that's basically what it comes down to. So, you want to make sure that your system is set up. And, what we have learned throughout this process going through talking to

different banks and talking to the core providers, there are a lot of fixes out there that the core providers have.

But, sometimes you actually have to make sure you get the update and you do the update. And, then sometimes you have to ask them to do it. So, it's not maybe something that they're sending automatically.

So, one, you need to make sure you know what your system is doing and then get with your core provider. And, if it is doing this authorized positive negative situation, you want to make sure you go in there and get it corrected so that these kind of situations are not happening. But, there are a lot of fixes out there.

But, we talked to a lot of institutions, and they didn't realize that was out there. And, they hadn't actually done the fix to it. So, you want to make sure you're aware of that. Okay?

The last thing is several resources that I wanted to point out dealing with this issue and other issues. Like I mentioned, we put out this particular guidance in 2023. That's the last thing on there.

But, the OCC has recently put out guidance on their overdraft protection. And, this APSN issue was in there. And, of course, the CFPB had their circular earlier that talked about these type of issues.

Now our particular one is just dealing with APSN. But, different agencies had different things they put out. Questions?

MEMBER RICHARDS: I do.

MR. FINNEGAN: Okay.

MEMBER RICHARDS: Help me understand because I have a real problem with the whole unavoidable. It's unavoidable on the customer's part. It's avoidable what I'm trying to say. They can just not spend the money.

If you have a situation where customer

has 100 dollars and they run their card for 75, we'll approve the transaction. Their available balance will show then 25 dollars. Their ledger balance is going to be 100 until that transaction comes in and posts.

They have a 50-dollar check that comes in the cash letter, and that comes in before that debit card. Sometimes the merchants don't release those debit card transactions for a couple of days. The check comes in and clears for 50, leaving them 50.

When the debit card hits, they're overdrawn. They spent 125 dollars. Why is that not an overdraft? And, we can't return the debit card transaction. We have to pay it.

Believe it or not, they don't always pay their overdrafts. And, so the fees help offset some of the risks that we take in having to pay the overdrafts. I'm concerned about -- the representments was the first shoe to drop.

Now we have this shoe that's dropping.

You're going to eliminate overdraft fees. The unintended consequences are going to be we're not going to pay overdrafts. We'll just return everything because why pay somebody in an overdraft if we can't be compensated for it.

I just don't understand, and it just galls me every time I see you all use the wording unavoidable because it's avoidable. Help me understand in that scenario of 100 dollar, 75 dollar debit card, and a 50 dollar check why we shouldn't be able to charge an NSF fee. They're insufficient.

MR. FINNEGAN: And, you make good points, and thank you. And, I can tell when I was saying it that got your attention. One of the things is our concern about the fees, make sure things are disclosed properly and they're not unfair.

I mean, that's what we're doing. And, the shoe drops. I mean, we're talking about one particular issue here. And, this, yeah, we

talked a lot last time about the representment issue and we've had lots of discussions about that over the last year or two.

The APSN is something that we've talked about for several years. I mean, this is something that we did put in our 2019 highlights and it was something that we've actually had banks where this has been cited for over the last several years. So, this is not something that -- a subsequent event like representment and this.

This APSN issue has been out there. But, what we wanted to do is get more guidance out to the industry on it because we keep seeing it. It's still out there.

And, our responsibility is, again, just like yours to make sure that the customer knows specifically what the account does. These are the fees. These are the kind of fees they're going to get charged and what the process is.

Our view on this is the way that is set up and that scenario is that the customer

doesn’t have enough information at that point to know when things are going to come in and when they’re going to clear and all of that. And, our view is that that is why we don’t think that’s reasonably avoidable.

MEMBER RICHARDS: I disagree.

MEMBER PERRY: But, they know what they’re spending or they should, so --

MEMBER CAMPBELL: I think I agree with what you’re saying and the timing. But, if they would use a thing called a check register.

MEMBER RICHARDS: They would be able to avoid it.

MEMBER CAMPBELL: My mom never bounces a check. Right. Everything goes into checks. I had to explain to her. She said what number I put in my check register for a debit card? Just put DC, you know.

And, so, yeah, they know they’ve spent that money. The problem is they don’t know what their balance is because so many of don’t keep a

check register now. So, I agree. I think it's avoidable because they chose to write the check.

MEMBER RICHARDS: Would you rather us charge the NSF fee on the check when the check comes in before the debit card hits? Because there's two transactions. Both of them together equal an overdraft. Should we charge the NSF fees on the intervening transactions that come in knowing that a debit card is going to be coming in later?

MR. FINNEGAN: You know, and I can't really answer that, I mean, as far as -- we don't dictate how banks handle the transactions. I mean, that is something --

MEMBER RICHARDS: You're trying to.

MR. FINNEGAN: -- that each individual has to do. No, we actually want them to be able to have the information that they have in order to make their decisions as they go through.

MEMBER SHOEMAKER: Focusing on the word unavoidable, I think the disclosures are

very important. But, also the methods that the banks use to communicate to the consumer their balance, whether it be mobile banking, text, telephone, paper. I hope there's some deference to the banks when we're being examined that we have done through these efforts to make it avoidable.

Number two is I serve on the ABA's Core Platforms Committee. And, I hear a lot of complaints about core processors. And, I think there tends to be a disconnect between what the core processors are saying they provide to the banks and in reality what they actually do for the banks because it is consistently, on that committee I hear, well, we talked to our core and they said that's not possible.

And, I know these are banks that are updating their systems, doing the patches, doing everything necessary. But, on some of these transactions, the cores just aren't able. So, I want to make sure that you all are putting the

pressure on them to the extent you can to accommodate the community banks. And, if they do it, if they do it, they're extorting additional fees for said service.

MR. FINNEGAN: And, thanks for those comments. And, we do reviews from a consumer compliance perspective on the core providers. So, this kind of information is help for us as we do those reviews.

MEMBER HORTON: Just a quick comment.

MR. FINNEGAN: Sure.

MEMBER HORTON: I think the net effect of this is that overdraft fee income is going away because in our market, Chase eliminated all overdraft fees. It was all over TV, right? And, then the large superregional in our market followed.

And, so I think what's going to happen is that source of non-interest income is going away. And, I feel we provide a valuable service. It's a lot better than going to a payday lender

or some of the other things that people resort to.

So, hopefully -- I mean, because with competition, how do we continue to charge fees if the big banks who have so many other sources of non-interest income, investment banking and wealth management. They could live without that. For us, community bankers who are so dependent on our net interest margin, it has been an important source and an important service that customers truly value and actually sign up for. They can opt out of it.

MR. FINNEGAN: Yeah, I mean, that's right. I mean, with the Reg E opt-ins. And, one of the things I didn't -- well, we've already passed on one of the resources.

Our guidance on overdraft -- from 2010, it's still out there. And, we have some, I think, good recommendations out there. If you're doing overdrafts and things that you could do to help address some of the risk that are

associated with it.

So, that guidance is still out there, and I think it still has some good things to do to encourage education to the customers, to ensure they're not constantly overdrawing and all of those kind of things. So, education and discussing with the customer and having other alternatives other than overdrafts. So, there's a lot of things that we still recommend as part of our guidance from so many years ago now that I think would be good as alternatives to overdrafts.

MEMBER HORTON: Well, and if overdrafts go away, I see free checking going away. I mean, somehow these things have to get paid for. And, you see a bank like Chase, I don't think that all of their accounts are free.

So, there's just a difference there. And, I think then you're penalizing everyone instead of charging those that actually use the overdraft protection service. So, I share your

concerns that I've heard around the table.

MEMBER BATES: Well, I think it becomes a difficult situation in that even though we want the consumer to be informed, they tend to learn how to use the system to their advantage. I mean, it's a very -- most people take their stack of paper we give them and they toss it when they leave. But, they learn how to use the system and how to avoid.

We will see patterns with certain customers. So, I mean, we try as best we can. We've actually modified our overdraft and return policies. And, we've given up a lot of NSF income voluntarily to try to get ahead and really try to probably, I guess, be more -- where they'll come to us instead of going to a payday lender. It costs us money, but it's lessened the burden on them. But, that doesn't lessen the risks that we're having to take.

MEMBER RICHARDS: Are you all not worried that if you eliminate the NSF fees that

it will encourage more overdrafts? Because in a large sense, NSF is our deterrent. People don't write hot checks and use money they don't have because they don't want to get the fee.

If they know that we're not going to charge the fee, can you bar the door? I mean, they're just going to be writing checks everywhere. And, that's going to create more harm than us charging the fee.

MR. FINNEGAN: And, you know, on NSF fee, we have -- that is not an issue that -- the first NSF fee is not something that we have had concern with. We've talked a lot about the representment part of it. But, it's the represented NSF fee.

But, we have not had any issue or findings dealing with an NSF fee as long as its disclosed and all those kind of things. But, we have not had an issue with the NSF fee if they did it and it comes in and meets what's disclosed and all of those kind of things. Our concern had

been it remains the representment part of that.

MEMBER REIGELSBERGER: In our bank whether the check or whatever it is, ACH comes in the first time, the second time, or the third time. There's days. We go through each account. I'll even look up their account and wonder when they get paid.

I wonder if we can go ahead and pay this today because they're going to get paid on Friday. So, okay, it was just a day or so away. I hate to turn back this mortgage check or their insurance.

We go through the exact same steps for every check that's presented, whether it's a first, second, or third. I don't go through any less steps because it's a second or third. I go through the exact same steps because you get to the point.

You know the same people are on there every week. You know when they get paid. You know Susie gets paid on Friday and hubby gets

paid on Monday.

And, even though it's not -- they've opted out of the program, they're still in the program because they're still writing checks. We do have an overdraft program. And, one example the other day was we had a gentleman call.

He was all out of breath and all excitable. He had gone down the road 120 miles to see somebody and didn't take any cash with him. But, he had his debit card.

He had his overdraft line. He was going to gas up his car and take the kids out to lunch with his line using his debit card. He couldn't understand why he couldn't gas up his car.

Well, and I think usually we have it set up to where if they have a line, it's not going to show up on the ATM as available. They just have to -- kind of have to know what's there. If they go to the store, they can use it, but it's not going to show up as available to them.

They just have to know it's there.

Well, he just knew it was there, and it ended up being a card issue. But, he was counting on that overdraft line. He said, I'll pay you twice the fees. And, we charged 35 dollars.

He said, I'll pay you 70 dollars. Let me have it. But the difference was that wasn't the issue. I mean, he had the line available. It was more of a card issue with where he was at.

But anyway, it's -- I don't know. It's really -- do you discontinue all the fees? Are we just not going to do it? I don't know. It really gets -- now on the authorize now, pay later, be honest with you, we quit doing that ten years ago probably or maybe a little bit longer.

As a result of an exam, we were probably one of those people didn't quite realize what was going on after some very strong words of encouragement. Anyway, we discontinued -- we changed our -- our core could change and it did

because we asked them to. We just did it the way it was presented to us when we went to the core. So, we should've known better probably.

But, we did get that fixed. So, we haven't been doing that for a long time. But when I think about the unavoidable, the unanticipated, I think it's a burr under all of our saddles because we know good and well that people could probably avoid it if they kept that checkbook.

Or now they just look on their phone and swipe through. Oh, yeah, I have 100 dollars. They don't think about the other times they've used it. And, the checks are coming in.

I said, well, if you're going to do that, keep excess money in that account to cover it. You're not going to remember every check you wrote or every time you used your debit card. So, just have a cushion in there if you're not going to keep track. It doesn't always work either.

MEMBER WEST: I just want to make a really quick comment. We just eliminated overdraft fees, and it just happened a couple weeks ago. I'll let you know in six months how it's going.

(Laughter.)

MEMBER WEST: We anticipated that it's essentially -- I don't want to use the word forced. But, we're going to be forced into it anyway at some point, kind of like what you're talking about. And, I just figured why not.

It's not that big of a -- after we came to the meeting last time, we were properly -- weren't you tell us last time? So, I'm sitting under the table texting my EVP, hey, are we disclosing this? Freaking out.

And, she gets back, yeah, we're disclosing it. But, I went back. And, I said, we're not charging anymore for second presentments. Just wipe it off.

So, we changed our disclosures. Well,

we left our disclosures but changed our practice, right? So, we could, but we're not. And, then I started thinking about it. And, the more I thought about it, well, it's not that much money anyway.

You're right. It is for a community bank. It's non-interest income. But, I thought, eventually, we're going to get -- it's going to become onerous to try to do it right. So, we just got rid of it. I'll let you know because I don't think there's probably anybody else in here that has eliminated overdraft fees.

MEMBER REIGELSBERGER: So, are you continuing to pay overdrafts? Or do you have a limit set?

MEMBER WEST: I'm not going say anything out loud.

(Laughter.)

MEMBER WEST: I think it's a know your customer situation. And, there may be some that we cover. We try not to let people use their

checking accounts with a line of credit. But when there's no fee, I would say that unofficial position is probably not very inclined to be paying overdrafts unless it's somebody that we really know is going to make good on it.

MEMBER REIGELSBERGER: Yeah, that's always a challenge sometimes.

MEMBER WEST: Yes, it is. And it'll be interesting to see how it goes.

MEMBER RICHARDS: I just don't think we think about the unintended consequences of these actions. Kind of, like, 1071, unintended consequences is going to be commercial lending is going to go pfft.

MEMBER WEST: It'll change it for sure.

MEMBER RICHARDS: And, then unintended consequences of this is if the consumer is ultimately harmed and it limits the services available to consumers and services that they want and that they ask for. But, they're going

to be gone.

MEMBER WEST: But, I'll let everybody know. I'll report back and let you know how it goes, hoping that it's going to be good. I'm kind of excited because two of our biggest regional banks are in my town. And, I'm going to put a billboard up.

(Simultaneous speaking.)

MEMBER WEST: That'll be kind of fun. I told my new accounts crew, better strap in. You're going to be busy.

MR. FINNEGAN: Well, thanks for the comments, and always a pleasure to see everybody.

MS. EBERLEY: All right. Well, thank you to all of our presenters and to the committee members for the insights that were shared today and for the robust conversation. Really do appreciate it throughout the day today. It really has been terrific and very helpful to us.

So, Vice Chairman Hill, before we close out, I wanted to give you an opportunity to

make any final comments if you would like. Okay. Thank you. So, I will turn things over to Chairman Gruenberg for some brief closing remarks.

CHAIRMAN GRUENBERG: Thank you, Doreen. I'll be very brief. Thanks, everybody, for your time and participation. From my standpoint, it's been a terrific day and a terrific and informative set of conversations.

Really, I think we've learned a lot. I hope you've benefitted as well and appreciate the candid conversation, whatever the issue may be. There's real value in that. So, thank you for that.

I did want to acknowledge that we had one member of our committee whose term expired in April. And, I just wanted to acknowledge his service, Anthony Capobianco who's President and CEO of American Community Bank of Glen Cove, New York. We're very appreciative to him as we are to all of you.

I think we're going to get back together in the fall and we look forward to it. And we'll see what things are like then. Thank you all very much.

(Whereupon, the above-entitled matter went off the record at 2:57 p.m.)