FEDERAL DEPOSIT INSURANCE CORPORATION

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ADVISORY COMMITTEE ON COMMUNITY BANKING

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MEETING

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WEDNESDAY,
OCTOBER 10, 2018

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The Advisory Committee convened at 9:06 a.m. in the Federal Deposit Insurance Corporation Board Room, 550 17th Street, NW, Room 6010, Washington, D.C., Jelena McWilliams, Chairman, presiding.

PRESENT:

JELENA McWILLIAMS, Chairman
MARTIN GRUENBERG, FDIC Board of Directors
CHRIS DONNELLY, President & CEO, Bank of the Prairie
JAMES EDWARDS, CEO, United Bank, Zebulon, Georgia
CHRISTOPHER EMMONS, President & CEO, Gorham Savings Bank
DAVID J. HANRAHAN, SR., President & CEO, Capital Bank of New Jersey
JACK HARTINGS, President & CEO, The Peoples Bank Co.
DANNY J. KELLY, President & CEO, Hometown Bank of Alabama
KENNETH KELLY, First Independence Bank
ARVIND A. MENON, President & CEO, Meadows Bank
TIFFANY BAER PAINE, President & CEO, Security Bank USA
MARY ANN SCULLY, President & CEO, Howard Bank
ALAN SHETTLESWORTH, Main Bank
JOHN M. TOLOMER, President & CEO, The Westchester

Bank
JOSEPH W. TURNER, President & CEO, Great Southern Bank
LOUISE WALKER, President & CEO, First Northern Bank of Dixon
LEN WILLIAMS, President & CEO, People's Intermountain Bank

ALSO PRESENT:

RUTH AMBERG, Assistant General Counsel, Legal Division
LISA ARQUETTE, Associate Director, Division of Risk Management Supervision
RYAN BILLINGSLEY, Corporate Expert, Division of Risk Management Supervision
CHAD DAVIS, Deputy to the Chairman for External Affairs
DOREEN EBERLEY, Director, Division of Risk Management Supervision
DIANE ELLIS, Director, Division of Insurance and Research
WILLIAM HENLEY, Associate Director, Division of Risk Management Supervision
VIVEK KHARE, Counsel, Legal Division
M. ANTHONY LOWE, FDIC Ombudsman
RAE-ANN MILLER, Associate Director, Division of Risk Management Supervision
PATRICK MITCHELL, Deputy Director, Division of Insurance and Research
MARK PEARCE, Director, Division of Depositor and Consumer Protection
Lisa Roy, Associate Director, Division of Risk Management Supervision
BETTY RUDOLPH, National Director for Minority and Community Development Banking
JAMES WATKINS, Senior Deputy Director, Division of Risk Management Supervision

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

(9:06 a.m.)

CHAIRMAN McWILLIAMS: I think we're good to begin. Good morning, everybody.

PARTICIPANTS: Good morning.

CHAIRMAN McWILLIAMS: That was a great good morning. We are so pleased to have new members of the committee with us, and I'll introduce them in a second. So we have Louise Walker from First Northern Bank of Dixon, Dixon, California. Welcome, pleasure to have you here. Alan -- where's Alan? Alan is over here. Alan Shettlesworth from Main Bank, Albuquerque, New Mexico. We have Ken Kelly.

MEMBER KELLY: Yes.

CHAIRMAN McWILLIAMS: Hi, Ken. Nice to see you.

MEMBER KELLY: Good morning.

CHAIRMAN McWILLIAMS: From First Independence Bank, Detroit, Michigan, and Jim Edwards from United Bank, Zebulon --

MEMBER EDWARDS: Georgia. Zebulon,

Georgia, yes.

CHAIRMAN McWILLIAMS: Zebulon, I got it.

MEMBER EDWARDS: Very good.

CHAIRMAN McWILLIAMS: All right, Zebulon, Georgia.

We expanded the membership of the committee to ensure that we have representation from different geographic areas of the countries, of the country, also that we have more representation from more diverse areas, so looking at rural, agricultural, farm landing, etc. We also want to allow more time for dialogue and input from the members, and for the new members, we're actually very friendly, we engage nicely, so I expect you to please, please provide your input.

This is not a perfunctory committee. This committee is supposed to serve truly to get your feedback. You can tell us what's happening on the ground, and we will implement that into our thought process and policymaking and move forward, hopefully, in a, in a productive manner where we can create an environment where our community banks can thrive, so we do expect you to engage, and I put my new members close to me, so I can poke you if you're not asking questions.

(Laughter.)

CHAIRMAN McWILLIAMS: You'll see from the agenda today that we are starting off by hearing from the committee members about your banks and your communities. And I'm going to turn the program over to Chad Davis, Deputy for External Outreach who will serve as the moderator for today's meeting. Again, welcome.

MR. DAVIS: Thank you, Chairman.

As the Chairman indicated, we're going to start with presentations or just a discussion, if you'd like to call it that, from the committee, so for this session, I'm going to turn it over to all of you. And we didn't just turn it to him cold. We talked to him ahead of time, but asked John to please kick it off, so, again, this is a very flexible time. Please tell us about your markets, your banks, whatever you find most relevant for this period.

MEMBER TOLOMER: Sure. Thank you very much, Chad. I appreciate it. The Westchester Bank was founded ten years ago. We are in the Westchester market, which is a suburb of New York City, and we are typically geared toward small/medium-sized businesses and being able to have a full suite of product for consumers as well.

What we're seeing in the market more recently is there's a great deal -- loan demand has been solid and growth has been in the 15-16 percent range year over year. Deposits, on the other hand, I think are a struggle that we're seeing throughout the industry, not just in Westchester County or in New York Metropolitan area, but I think nationwide.

One of the things that we're seeing is some of the larger banks are looking to, I think, bolster their liquidity and are offering higher rates than normal, and so when you talk about the normal rates nationwide, it tends to be very different in New York, because you have regional banks and larger banks offering 1.75 for money market rates and 2.5 for one-year CDs, and those are -- creates a great deal of pressure for smaller banks to be able to build their business.

You know, we've always said we want to do well by doing some good in our market, and when you have that pressure, it's certainly, you know, has been difficult from a competitive standpoint. The good news is with the tax cut, our year-over-year profits are very strong, and even if you back out the effects of the tax cut, we still have fared very well.

We're lean. We utilize technology where we can and consultants where we can to augment what our employees are doing, so it's -- I think, as we look forward, I think, banks have to really look at what is going to happen to -- there's greater pressure for deposit rates increasing, and, of course, there's pressure from customers not to increase our loan rates, and so, you know, with the relatively flat yield curve, it's something that we all have to consider as, how do you handle your business on a going-forward basis?

Thus far, we've been able to compete. We're asset sensitive and -- but in terms of the overall market, there's -- there isn't any lack of competition, and, certainly, you know, we are -- have learned to put forward the loan proposals that we think make sense for us and for our shareholder.

Fortunately, we've been able to win more than we've lost, but you do sometimes lose to banks that want to have a more aggressive approach to terms and conditions, something we're not comfortable with, and, also, there are pricing considerations. Some of the larger regionals for multifamily will -- are still below four percent, which is beyond my comprehension as to how they can do that effectively, but they are, and it's something that we have chosen not to do and we'll continue not to do that.

So, I think discipline is -- I don't mean to pontificate, but I think discipline is the order of the day of how you operate your business, and looking at the deals you want to put forward, for the credit quality you want to put forward, and recognize there's going to be pressure on margin, and how you go about managing that is going to be very important for the future strength of your organization.

So, if there's anything that I didn't cover, I certainly am open to any questions.

CHAIRMAN McWILLIAMS: Thank you.

MR. DAVIS: Great. Tiffany, can we turn it to you?

MEMBER PAINE: You know, you didn't talk to me beforehand.

(Laughter.)

MEMBER PAINE: I'm Tiffany Paine. I'm from Security Bank in Bemidji, Minnesota. Just to give you an idea where that is, we are four hours south of Winnipeg and four hours north of Minneapolis, so we are in a small rural community that is very diverse.

We have -- in the 20-mile radius, we have about 50,000 people and we have 10 financial institutions competing for their business. That does not include brokers or anything like that, so

I'm going to say ditto, yes, what John said, but exactly looking at your balance sheet on a regular basis, managing that on a regular basis.

We have been fortunate enough to grow over seven percent in our loans in the last two years and over eight percent in our deposits in the last two years. One thing that I know will come up later is the reciprocal account conversation, and that's a big thing for us, so I'll wait on that conversation.

But what we are seeing in our markets is a little bit of the, maybe loosening of underwriting in some situations. You are seeing people that are willing to, to get the money, again, adjust their terms, adjust their rates, lock in for longer, and you see customers shopping for that on a regular basis.

What they're basing that on maybe, for example, is they think they should get better terms and better rates because their score on Credit Karma is 800 and they come in and they want to debate why Credit Karma is right, and the three agencies that you're pulling their credit report from are wrong. So there's a little bit of misinformation out there for the consumer and it's readily available to them. And because they have this information, they think that they should come in and get these better terms.

We are seeing that that goes to the fintech disruption a little bit. It's not just the apps that you can get. The immediate approval, which is also untrue, which to me falls under UDAP, but it does take a longer term, and then the question is, "Who's regulating them, and how is that being taken care of?"

It's the Credit Karmas, it's the -- all of that disruption coming in. It's the spam, it's the phishing, it's the -- all of the different technology aspects of it.

Then, what -- another thing that we are seeing is that in the state of Minnesota, brokers only have to take a test to get their license. There's no continuing education that is required, I believe, from them, and so they don't understand our smaller market, and so that actually is good for us on one side of it, but it does create a bit of a challenge.

We are starting to see customers trying to stretch their limits, trying to push the ratio limits, put little money down, borrow to fix up immediately, so we're starting to see that, and to help rein them in can be a bit of a challenge.

Manufacturing -- manufactured housing is still a challenge. If we put the same customer through our system and that customer will -- for a manufactured home will come up denied or caution, if we put a stick build in there, it's approved, so I think in our area, again, in rural communities, not everybody can afford a stick build house.

And construction is coming in over as it typically does, so manufactured homes are good opportunities. If you have a large farm or a family farm and the parents give the kids some of the acreage, to finance that manufactured home is still a challenge and that's unfortunate, because those are future customers we want to build.

Credit consolidation companies are popping up again, and it's a challenge. People are getting stuck, and they, they don't read the fine print, so eventually, they're coming back to us.

I have several topics, but I'm going to pass it on, and we can discuss them in the future. Thank you.

MR. DAVIS: Chris, could you go next?

MEMBER DONNELLY: Thank you, Chad. I'm Chris Donnelly with Bank of the Prairie, $140 million, two-location branch, a bank in Olathe, Kansas. Olathe is a suburb in the southwest part of Kansas City, Missouri metro, about 140,000 people and growing quite well.

The bank, we've experienced some significant growth, and then back in January, we kicked the brakes on pretty hard and then are pushing them harder, because the small business community is doing well. We're starting to see some stress in the real estate market, single-family housing construction.

In fact, we saw it start to trickle down from the larger more expensive houses, and they were starting to slow early on in the year, and now we're seeing it even down in the more affordable housing, so we've really decided that it's probably best to let somebody else get into that business.

And the small business sector by itself -- and we're a well-diversified bank with real estate, commercial, C&I, very little ag, but in the ag that we do have is struggling still. Then -- and it does not appear to be anytime soon that that will repair itself.

I think probably our biggest challenge is gathering deposits. Our cost of funds has increased pretty rapidly. As a small bank in a metro community, it's hard to gather deposits. Our headquarters is directly across the street from Garmin International where there's 3,000 employees and they're adding 2,000 more, and it's hard to get those young engineers to bank with a small community bank and bring their deposits in.

On a daily basis, I tell the story that probably 500 electric, or electronic engineers, whatever they are, at Garmin walk through my parking lot and go to a restaurant or go to the convenience store across the street, and it's hard to get them to come in and -- when you're not a large regional and have all the technology, and so those deposits are hard to find. And with the cost of funding going up, it's hard to see how you can make a profit in a small bank.

I was sitting with some of my colleagues at a table this morning, and they were talking about interest rates in the fours and fives for loans, and we've started pushing six percent and we are now seeing at that rate that customers stop borrowing money.

Deals quit. They just won't do the deal. And I don't -- I don't think they recall the time when six percent was a really, really good interest rate, and it still is a good interest rate, but when we start to see that pressure, we start to get concerned, and so that's why it makes sense, for us at least, to maybe back off a little bit and see where the markets are going to go. It's disconcerting to see good solid projects back away when you get approaching to a higher interest rate at six percent.

So, that's kind of it with Olathe, and I'll pass to Len here.

MEMBER WILLIAMS: Great. Thank you. Well, I'm Len Williams. I'm with the People's Intermountain Bank, which is the bank associated with People's Utah Bancorp holding company. We're about a $2.2 billion bank located just south of Salt Lake is our headquarters, but we've got 25 locations throughout the state.

And it's been a -- it's been a pretty good run here the last several years. The state has a lot going for it. Favorable business climate, tax rates, so there's been strong in-migration. It's been the top two or three in the country the last several years. Same with job growth, same with income growth, so all of those going for you have been very helpful to us and the banks in our market.

A competitive area from a credit union

perspective -- also, Utah is one of the states that really encourages the ILCs, the -- and right now as the last couple of weeks, there are four or five applications in for new ones now, so we're starting to see a little bit of bank charter application growth.

The industrial loan companies are not direct competitors for us in our market, but they're direct competitors for all of us in all of our markets. They actually go out nationally. For their lending, they tend to fund themselves predominately with brokered CDs, and other sources, so it's -- it's good for the Utah Bankers Association, good for the membership, the growth and the support, and they tend to be fairly innovative too, so we do have some collaborative opportunities with those folks where we talk about different ways they're funding their bank, different type of technologies they're using to -- on their national scale, so that's been interesting for us.

Some of the issues in our market,

there's starting to be the affordability index for residential housing. There's been a lot of in-migration to where a lot of the local kids, the folks growing up in the market, are having a hard time affording new homes. That's becoming a bit of concern, as is real estate concentration, but, again, there's a focus in that area.

While there's virtually no new home inventory for sale, you know, having been in the industry for 40 years, my spider senses are starting to tingle a little bit. It's just a matter of when and how severe the next downturn is, so we spend a lot of time now focusing on what we don't even see yet, which is how do we prepare our balance sheet, how do we prepare our funding for a slowdown in the real estate market, which we think will probably happen in the next couple of years in our market.

So, it's been great for organizational profitability. We've had record years the last several years. It continues on at this point, but we are seeing deposit -- you know, it was nice those first four rate increases, nobody raised their rates. In these last three, people have gone, at least in our market, rates have climbed exponentially particularly for deposits, and we continue to see that, so funding costs are going up, margins are being squeezed a little bit, and we continue to be concerned about that as well.

MR. DAVIS: Thanks, Len.

MEMBER HARTINGS: I'm the other Peoples Bank in the group here. Jack Hartings. I'm with Peoples Bank in Coldwater, Ohio. We're about a $500 million institution, 7 locations.

I was listening to the population size. I think our county is about a 40,000 population. The counties that surround us, roughly 50 or 60. We're the number one agricultural county in Ohio, Mercer County.

Agricultural is suffering, but the rest of the economy is going well. I think our unemployment in our county is less than three percent right now. And we're starting to see effects certainly on our own income, but from the tax changes, but several manufacturers.

We've got one in our area that's building about a 500,000 square foot building. They build forklifts. We've got a recreational vehicle manufacturer in the area that's adding on 800,000 square feet. Those are just -- the dirt is just being turned today, so those are going to have some long-term effects.

And, you know, when I talk to the other small businesses about why they're feeling maybe good about the economy and expanding right now, certainly, they look at taxes, they look at the general economy, they feel the sense of a more common sense regulatory environment, that's kind of what they passed on to me, so things on that side look good.

We're having a housing push as well. It's just the really affordable housing as construction costs rise. We're a fairly substantial residential lender at our institution. Haven't seen the rates slow that down yet, but I think you'll see that in maybe these fourth and first quarter, because they mostly track the ten year, and as you guys know, the ten years are -- is coming up the last couple of weeks.

When I talked to the other bankers in the area and ourselves, we're starting to see deposit pressure. When you're a banker, you first look at the special rates on CDs, money markets, but those rates are now creeping into all rates, and so I think that's, that's maybe the change we're starting to see over the last month, but most of us still, at least in our general vicinity, have fairly good lines.

It's been good loan growth, but most of us have seen our growth moderate a little bit. I think most of us are still growing in different industries, depends upon what we're into.

Concerns out there, I know we didn't talk about regulatory too much yet. The reg burden of TRID I want to say is kind of behind us now for two reasons. Number one, a lot of banks just got out of mortgage lending, so I'm not sure that's a good thing, but the rest of us that have stayed in it, if you give us a little bit of time, community bankers are usually pretty good at handling regulation, but you can't throw it all at them at one time.

And we're getting used to e-documents. There are talks to the CFPB about improving those a little bit, making them a little bit better. We're all getting used to beneficial ownership, another latest reg burden on all of us. And the biggest frustration that I have with beneficial ownership is we have the same customers, and they come in year after year. We have lines of credit, we have those, but every year, I've got to have this beneficial ownership form.

And a lot of my customers I probably have had their lines of credit for ten years. In their file, it's going to be ten beneficial ownership signed forms, which -- you know, I get one resolution from these folks when they come in, and if they don't change their organization, I don't get another resolution. I get their ID one time until they change their ID, so those are just a little bit of frustrations.

I know that the regulatory agencies are looking at the simplified capital rules. We think that's very important. Again, we're a $500 million bank. I would just ask -- I think it goes to the heart of our franchise value that you consider that in an 8 percent minimum and not 10, because 8 is really 9 and 10 is really 11, because as a banker, if you put the minimum at 10, probably not going to operate at 10, I'm going to operate at something higher than that.

And, again, those are all little pieces that help us as community banking. I've been around a little while. I've been president at my bank for about 28 years, I'm previous chairman of ICBA, so I get a chance to talk to a lot of bankers.

And the one thing, I think, we got give ourselves credit a little bit, we're pretty good at cycles. I know we're seeing deposit pressure, but in some respects, we saw the growth on our depositor backs, and so I don't feel too bad if I got to pay a little bit more interest rate. I mean, I certainly have to balance that, I understand that, but that's -- that's kind of how we look at it as more of a holistic way of taking care of our customers, so we're confident that the economy will stay fairly strong in our area.

Concern with liquidity, concern with, you know, the rate burden going forward, but our bank is 115 years old, a little over that right now, so we hope we've got another 100 years in us, so --

MR. DAVIS: Alan.

MEMBER SHETTLESWORTH: Hi. I'm Alan Shettlesworth, Main Bank in Albuquerque, New Mexico. I looked at our balance sheet this morning in my hotel room, and we're about a $139 million in total assets today. Our bank started in November 1, 2005, and I can tell you that was both the best of time and the absolute worst of time to start a bank.

We ended up acquiring a bank with about 30 million in total assets - helped advance our, I guess, our game plan going forward, so we've had an acquisition since that time period and a lot of business cycles and a lot of business changes for us.

Our specialty right now is primarily in the commercial, in commercial real estate space. That tends to be what we know. We are small, and I'm proud to report that we just made a hire last month, so that brings our employee base to a whopping 13 employees, and it puts a little bit of strain on our folks back home, because when I'm here and they're away -- when I'm here away from the bank, they have to coordinate bathroom breaks a lot better than---

(Laughter.)

MEMBER SHETTLESWORTH: For us, you know, the deposit market in New Mexico is 40 percent controlled by two big banks, Wells Fargo and B of A, and so we have some of a benefit from there, because those banks have not really increased their rates.

We have started to increase our rates because we are growing and we continue to grow.

We'll probably hit between 8 and 12 percent total asset growth and total loan growth, and so we are currently actively raising our costs of funds right now, and so our costs of funds in the last 12 months will have more than doubled, and that is putting some margin compression. That's presenting some challenges for us.

We, in 2010, got into the mortgage business. We hired a group that was pretty successful and that had been basically kicked out by the, by the recession. Since they didn't have a lack of the funding or liquidity for their mortgage loans, we brought them in-house.

Did that program for about 2015, and then we looked back and realized at the end of 2015 that our cost to produce a loan had more than doubled exclusively because we had hired more bodies for compliance burden, and so it was becoming an unreasonable burden for a bank of our size at that point.

We had more employees at our mortgage division than we did at our commercial bank. In order to make that successful long-term, we thought we would need to have doubled the size of our production and that would have probably put too much pressure on our capital and too much risk for that, for that piece, and so we exited the business in 2015. Since then, we've continued to grow.

In our market -- in Albuquerque, I'm not quite sure if we have, if perhaps technically we have made it out of the recession, but at such a slow pace that by the time, you know, the next recession comes around, I've heard the r-word said for 2020 that's potentially when the next recession is coming.

I'm just concerned -- our big concern is that Albuquerque will just have made it out of the recession in time for the other one, and so that's a real concern of ours, but we're -- we're -- because of our small size, in spite of the fact that Albuquerque isn't doing incredibly well economically compared to surrounding cities and surrounding states - Arizona, Colorado and Texas, we're still able to grow in spite of all that, because of our size.

We have one location and that is probably our big challenge and we are strategically going forward. We're not interested in branching. We're not interested in multiple branches. We lend exclusively in our market, which is the Albuquerque area, and we're going to continue to do so.

We should be able to get to 500 million before we need to worry about any other branches, and so that's another challenge for us. In some regards, I feel like we are closer to an Internet-based bank than we are to a local community bank, because of the one location, so that creates its problems and challenges for getting depositors, certainly for the younger generation.

Yes, so -- so we're doing fine, but I just say because of our size, and so we're continuing to do what we've always done. In our local market, I would say that some new trends that have started up this year have been out-of-state lenders coming in to Albuquerque originating a lot of SBA 7a transactions. Those are the transactions that you can do a lot of real estate-based transactions.

A lot of folks are getting very aggressive terms with 10 percent down and 25-year amortization loans, and we -- we wouldn't do those loans even with an SBA guarantee, and so that is probably one new recent trend we're seeing.

When we started the year, there were 38 banks that were based and headquartered in New Mexico, and by the time we get to the end of the year, we're going to have 36 banks. It's unfortunate to see that from our standpoint, but there are other larger out-of-state banks that are coming in to New Mexico, I think, almost exclusively for access to our low cost of funds, our deposit market, and so while that's a very big negative for New Mexico, that's a huge positive for Main Bank as we look around and we're about the only locally owned, based bank there in Albuquerque.

So, thanks for having me.

CHAIRMAN McWILLIAMS: Thank you.

MEMBER EDWARDS: Good morning. I'm Jim Edwards. I'm CEO of United Bank, which is based in Zebulon, Georgia, which is only about 40 miles south of the world's busiest airport in Atlanta. Interestingly though, the county where our bank is headquartered has just 2 stop lights and less than 20,000 people in the county, so we operate in 10 counties, contiguous counties sort of in a southern arc around the southeast and west side of Atlanta, and it's an interesting mix.

The communities closer to Atlanta are more suburban, and then we go all the way down to about 60-70 miles south of Atlanta, and those communities are more rural. Bank is 110 years old. It's a Sub S bank, and I'm really proud to be the third generation in my family that's involved with running the bank.

We also have trust and mortgage, pretty large trust and mortgage businesses. And the bank's loan mix is really -- we're a traditional community bank. I mean, we do a little bit of everything from consumer to C&I to real estate lending.

I think many of you in this room remember, or I certainly do, how challenging the recession, the great recession was in Georgia from a banking perspective. We lost about a third of our bank charters during that, during that time.

In one of the counties next to us, we lost every community bank that was headquartered there, so we, fortunately, are little bit further away from the epicenter when things turned really bad there, but I think the good news today is that the Georgia banking market is back and I think it's healthier and I think many of the lessons that were learned back in that recession were learned well. And we are not seeing a real loosening of credit standards in that market now and that's good to see.

We are seeing, however, a good bit of, I guess, pricing pressure on the loan side, which is, which is somewhat interesting with rates rising. I think there's been this, a little bit of a feeling that rates just weren't going to rise, that never really was going to happen, and certainly as we've seen this week and over the last couple of years, that is beginning to happen, and so we're starting to see some pressure on deposits just as the other bankers here have mentioned.

I think it's going to be interesting to see what happens with all of that, because earlier in my career, you know, half of our balance sheet would be made up or better of local CDs. We've seen a transition out of that due to low interest rates over the last five or six years here, so we're trying to pay a lot of attention to what happens with those deposits, because unlike earlier in my career when my primary competitors were right across the street from me, now the -- our competition we feel like both on certainly the deposit side and from a growing perspective on the loan side are banks all over the place and nonbank lenders and nonbank opportunities to invest money, so I think we, just as bankers, have to be very cautious and concerned about that and not just say, "Well, this is -- we don't have a problem because this is our little market here, we're okay."

I think consumers are looking, as we've heard from some of the other bankers here, they are spending more time in comparing and there's not that reluctance to maybe do, to work with somebody out of state that there was, that there was in the past.

But, you know, from a portfolio standpoint, you know, loan quality metrics are frankly as good as I seen in my career. Just charge-offs are virtually nonexistent, problem loans are extremely low, and so I like the, what one of the former speakers said, you know, "That makes my spider sense tingle," too. You know, it feels almost a little too good to be true here, and I think we have to be careful in this type of, this type of environment here.

We're spending a lot of time trying to figure out how to stay on top of technology for our consumers as well. That is a challenge. One of the bankers who was, spoke previously about his Garmin customers potentially, while we don't have that, you know, gosh, anybody under the age of 40 it seems like is if you don't have the latest in technology, it's a challenge.

And, so, for -- even though we're a billion three, it's still a challenge for us to figure out how to implement the right technology to work with, and there's some really good solutions out there, but frankly, trying to make those solutions work with our core data providers has been a challenge for us.

I think the cores are at least saying the right things about trying to integrate with more, with some of the latest technology, but that's something that we're spending time working on and trying to stay out in front of.

And, I think, finally, one thing I'll mention is a challenge that we're facing and spending time working on is how do we recruit the next generation of bankers. In Georgia, you know, the first thing that happens when you get into -- that happened during the recession was people stopped training, they cut training budgets, they cut hiring staff, new staff, and so ten years on now, in some cases, we turn around and we look for that next generation of leadership and it's not there.

And I'm talking from an industry standpoint, but we've -- and we sort of have over the years, you know, the typical pipeline was we would, we would hire the young person who maybe got out of college, went to work for one of the regional banks, and was ready to come back home, and they were well trained. That market is not really out there as much.

We find that most of the larger banks are training more specialists, and so for the community bank world, we need more of a generalist, and so we've just had to start our own training programs basically.

And we're doing that now, and, fortunately, are having some good results with that, but I think as an industry, we've got to work to figure out how to attract, to show young people that banking can be a very satisfying and good career. And I think we've got some work as an industry to do there, but I do think that there are very good opportunities to do that, but we've got to -- we've got to get out in front of that, I think, and we're working hard to do that in our institution, so.

This is my first meeting and it's a real honor to have a chance to do this, and I appreciate the opportunity to participate.

CHAIRMAN McWILLIAMS: Thank you.

MEMBER EDWARDS: Thank you.

CHAIRMAN McWILLIAMS: Thank you very much. I won't have to poke the new members - they are talking. This is good.

(Laughter.)

MEMBER WALKER: Yes, so I agree with Jim. It's an honor to be here, so thank you. I'm Louise Walker. I'm the CEO of First Northern Bank, which is a community bank in Dixon, California, which is located between Sacramento and San Francisco.

We are $1.3 billion organization, 68

percent loan-to-deposit ratio, which is unique for our area, because a lot of the banks are running in the 90s to 100, 8 percent loan growth, and about 5 to 6 percent deposit growth. We operate in five counties in that area, so very metro, but yet, rural at the same time.

And right now, we're working on digitizing everything, but to just give you an idea of the market conditions in our area. The Sacramento Valley region right now is very strong. In the area of regional housing, the median closing price on a detached home is around 470,000, attached homes 592,000, homes priced between 400,000 and 500,000 are the most active if you can find it, affordability is a huge issue in California.

And right now in the Sacramento area, it's about a 35 percent affordability ratio. Supply is extremely tight. To give you a feel for that, we need about 9,000 homes per year. At the peak, we were building 17,000 to 18,000. And last year and this year, we're at 6,000.

Again, affordability is an issue. However, we are seeing buyer fatigue and price increases and also increasing rents and that's a real difficult situation, because it's hard for people to save if their rents are continuing to go higher.

The biggest thing I hear out there between -- in the home building area and talking to home builders and business owners is this shortage of labor. Labor is a huge issue, especially in California, and because of that, that's a natural kind of governor on overbuilding, like we did last time.

There are also, right now, is in the residential housing area adherence to strict under-guiding -- underwriting guidelines, higher interest rates, and the impacts of new tax reform as reasons for why we think the housing market will continue to be stable.

And -- but, again, we need more affordable housing. The cost to build, about one-third of the cost is for governmental fees.

Also -- now, I'm going to move to the commercial real estate area.

Again, that area is very strong. Valuations though, we think are stretched compared to risk-free alternatives. As interest rates increase, we're going to start seeing a repricing of risk assets, and so that's very much a concern for us. We're seeing aggressive lending in the commercial real estate area.

And I can give you some examples, but I'll give you them later. Because some of the banks that are running between the 90 to 100 percent loan-to-deposit ratios are focused on commercial real estate, and so because of that, we're seeing deposits become, become an issue, become an issue.

We -- on the commercial small business side, strong business conditions, again, the biggest issue is the shortage of skilled labor, especially in our area, because of the wild fire damage that was done, so it's very hard. We're getting labor coming in from other states. And in California, regulation and higher labor costs are an issue.

Ag -- in the area of ag, crops grown in our market are strong. We build, not build, but we grow a lot of permanent nut orchards, rice, tomatoes, grapes. We are seeing a steady climb in bearable acres. Our concern in this area is the dollar and its impacts on commodity prices.

Also, water is an issue. It continues to be a challenge. California has passed a law where local management of underground water will be implemented, and so we know that will impact crops and land prices.

So, overall, our markets are doing well. Although, we are seeing -- because we also are close to San Francisco, what we're seeing is because of home affordability, a lot of the population is being pushed out up into our area.

CHAIRMAN McWILLIAMS: Excellent. Thank you.

MEMBER WALKER: Thank you.

MEMBER KELLY: Good morning. I'm Kenneth Kelly. I serve as Chairman and CEO of

First Independence Bank in Detroit and would like to say to Chair McWilliams, thank you so much for allowing us to join this committee and represent our industry, in particular, in the Detroit, Michigan area.

Our bank is roughly 250 million in assets. It's been in existence since 1970, so we are in our 48th year. Our bank has predominately been based on three prongs. One has been the residential markets. We've also had a fairly strong commercial practice along with equipment leasing.

As many of my colleagues mentioned earlier, we have had to really cinch back on the consumer lending aspect, because it just has not been as profitable in trying to manage our ratios. Our challenge right now really has been focused on ensuring that we are profitable.

For a bank our size dealing with the compliance issues -- I heard one of my colleagues speak of -- it becomes very challenging for us to, to do things in a profitable manner. For instance, in the residential market, we have had a challenge in just running that business in a way that's been profitable, but we've made a commitment to the people of Detroit that we were going to be in that business.

And, so, what we've done is try to continue to streamline and look at ways that we can make mortgages in such a way more affordable from an in-house practice perspective, but that is a very big challenge, so regulatory aspect of that is something that we continue to try to address and try to adjust to, but it's one of those areas that it's just really challenging for us from the residential mortgage side.

When I think about our overall economy, I will tell you the state of Detroit is very good. If you reflect back maybe ten years ago when you saw what was going on in the auto industry, and so as the auto industry, so you saw the tail of Detroit.

Today, you are seeing a change in the momentum within the city. There have been quite a bit of investments in some of the, I'll call them, people who have a large stake in the city, such as Dan Gilbert and many others, that has really created a resurgence in Detroit, and Detroit has become more of a destination than it was ten years ago.

That has brought more interest into looking at creating and starting businesses in Detroit. It has created an opportunity for more collaboration. And I can say publically, we've done a collaboration with Chemical Bank, which is the largest bank in the state of Michigan, and so, we're seeing more of a collaborative effort around Detroit and looking at ways that we can improve banking, because banking is the cornerstone of overall economic development.

I'd also like to make a quick comment as the incoming chair of the National Bankers Association, which has really been the voice of minority banking since 1927. Some of the challenges you heard my colleagues talk about really impact minority banking.

And I can tell you firsthand for us, one of them is capital. In fact, if you look at our ratios today, we're actually having to manage to capital. We could grow easily in the double-digit range from a long-growth perspective, but we're trying to manage our capital at this point in time. And I would tell you that's a theme that definitely runs through many of the minority banks in the country.

The other items I will tell you, one of my colleagues mentioned a moment ago, is succession planning. When you go from a market that had 15,000 banks and the luxury of navigating 5,600 banks, everyone is managing all their costs in a way that they're trying to manage their, their ratios of ROA and ROE, and so you just do not have the luxury of bringing in succession planning.

And I will tell you, for us, that's very challenging, because I can't just go hire that new hire right out of school. I'm waiting on them to go get trained by one of the bigger houses, which then, I can't afford to bring them in, because they make too money over there, and, so, my point there is as we think about this industry, we've got to think about it a little bit differently in how we bring in talent, especially for small institutions, and be creative in dealing with that.

The other topic I will bring up is, and, I think, one of my other colleagues mentioned this, is how do we really be attractive to the millennial generation. We think they think differently, but they just think in a different manner. I won't say it's different.

The point I'm trying to make is when I look at my customer base, my customer base has a tail end to it relative to the demographic of age. And when I look at my long-term sustainability, I know I've got to figure out how to become attractive to that age group in such a manner that we can be prosperous going forward, not 5 years from now, but 10, 15 and 20 years from now.

And, so, I want to have -- I want to mention that because as you think about it from a regulatory perspective and you look at the fintechs that are out there, and I mean, I heard Credit Karma mentioned by one of my colleagues, but there are others that are out there who are going to be attractive to a demographic that could change all of our businesses, and so from a regulatory perspective, my suggestion is to think through how can we in a way create a marriage there in such a way that is not disruptive to these institutions that are critical to our community.

And my point being as I talked about capital, I can put a business plan together to do an app and to deal with fintech and can raise money a lot faster than I can with a solid business that's been in business for 48 years, so I'll end with that comment.

CHAIRMAN McWILLIAMS: Thank you.

MEMBER EMMONS: Good morning. I'm Chris Emmons. I'm the CEO of Gorham Savings Bank in Portland, Maine. We are a $1.2 billion mutual. I'm not sure that there are many mutuals represented at this table today, but it's -- we are celebrating our 150th year this year.

The Maine -- if you're not familiar with Maine, population, total population of about 1.3. We are in the southern part of the state. And the southern part of the state is the most, is the most productive from an economy perspective. Two hours roughly from Boston. Go Red Sox.

(Laughter.)

MEMBER EMMONS: So -- and a lot of the trends that we're experiencing in southern Maine are reflective of what's happening in the rest of New England, and in particular, liquidity and real estate are the two areas that, that we're all focused on.

You had mentioned, I think, your loan-to-deposit was 65 percent somewhere, yes, so we're 130 percent loan-to-deposit. We manage to our capital as well, as a mutual. Our only source of capital is through earnings, so it's important for us to have the eye on the bottom line.

It's -- our greatest challenge today is liquidity. We're seeing some of the same pressures that others have spoken about regarding customer source deposits. Our strategies have been supplemented a little bit by the fact that we're seeing a number of the larger institutions shedding branches in our markets, and so with a strong CRM system, we're able to identify opportunities and take advantage of some of those customers that are leaving the larger institutions.

We talked about workforce, meet the challenges around workforce. Interestingly, we are the oldest state in the country. We are challenged by our young, our young residents moving out of state, graduating from college, and seeking their fortune outside of Maine, so we're particularly challenged around how to attract people into our workforce.

We have a program at the bank. It's a millennial group that we've put together that we're not quite ready to turn the bank over to them, but if given the opportunity, they would gladly take the reins.

They are very helpful in setting the

pace on technology and the adoption of technology and they, you know, they are a -- within themselves, they are a great source of attracting other, other young people to our, to our institution, so -- so, I think, asset quality at our institution has been, has been exceptional. Our challenge is really built around the liquidity.

Real estate, I can tell you that we all have our eye on a proverbial bubble. I think, southern Maine, in particular, is starting to see real estate prices that are reflective in the Boston market, so we're paying attention to our underwriting and making sure that, that we have strong recourse in all of our, all of our transactions, but market has been pretty solid in southern Maine, and, I think, we got another 150 years in us, so thank you.

CHAIRMAN McWILLIAMS: Thank you.

MEMBER SCULLY: So, I'm Mary Ann Scully. I'm the CEO of Howard Bank. Howard is a $2.1 billion bank headquartered now in Baltimore and started in 2004, so clearly, a lot of organic growth and a series of acquisitions over the last 14 years that allowed us to do that, as did diversifying our capital sources. We became an SEC registrant in 2012, and that access to the institutional markets funded a lot of that growth.

From an economic perspective, I think, like most of the people around the table, you know, the local economy is strong. While it's not the D.C. market and often suffers from a comparison to the D.C. market, it benefits by the contiguous nature. Many of our customers do a lot of business in greater Washington.

I think probably the unique element about our local economy, maybe unique to this table, is the fact that we've focused on small and medium-sized businesses almost exclusively. When we started the bank in 2004, we made a decision to not really try to attract mass market retail as we were concerned that even then it was largely a big-bank game and that we would not be able to compete successfully.

And the focus on the small and

medium-sized businesses has served us well, but the market that we serve, being greater Baltimore, is probably one of the greatest examples of the income inequality in the country side-by-side.

We were formerly headquartered before our last acquisition in Howard County. Howard County is the fourth wealthiest from a household income standpoint, fourth wealthiest county in the United States, and it sits right next door to Baltimore City, which is clearly one of the most challenged local economies.

And that certainly impacts us probably more from a community development, a philosophy perspective. I mean, we have plenty of places around Baltimore City in which we do business, but that sincere desire that we have as a community bank to help the city is a huge challenge and creates a lot of noise, and some of it impacts the ability to attract and retain talent when we moved our headquarters back into the city.

Generally speaking, what we're seeing from a commercial standpoint is, I would say strong, but not as robust C&I growth as we would have anticipated. And what we've observed over the last 20 months is basically that many of our C&I customers are taking the gains that they received from the tax law changes and are investing it into their businesses, which is good, so employment growth, but at the same time, we're not seeing them so confident that they're moving back into a traditional borrowing mode.

So, for example, we see our line usage is much lower than it was historically. I would say many of our business customers remain more cautious than we would have anticipated.

We're concerned about the CRE market, the non-owner-occupied CRE market in particular. That's probably the one market where we're seeing some of those late in the cycle evidences of lack of underwriting discipline in terms of a lot more non-recourse financing being done, extension of interest rate terms.

I mean, we're seeing commercial banks offer fixed 15 and 20 years, not the traditional

5- or 7-year fixed-rate financing. We're seeing a much higher loan-to-value, so a lot of things that begin to look reminiscent about 2005 and 2006.

And, then, of course, we're seeing in the CRE market locally a lot of nonbank competitors, so we're seeing private equity funds, we're seeing insurance funds. Again, not unlike the C&I example that I gave, just, I think, examples of still a lot of liquidity in the market and the impact that that has on structure and on pricing.

We have a relatively strong housing market. I think like some others have talked about, the housing market is being adversely impacted however by a significantly rising cost of development and construction, the development, just the scarcity of land, and so much higher prices for land.

Much higher development costs, especially in some of those strong parts of greater Baltimore where there's not necessarily a desire on the part of the counties to see an influx of people, and so they're making it more difficult and more expensive to develop, so before you even put a stick on the property, you're seeing much higher costs of the land acquisition itself and the development, and then the stick construction has increased dramatically.

And what that means is that in our market, you're starting to see the small and the regional home builders come under much more pressure, because it's the national builders that are able to compete. And, obviously, those national builders are not going to be our natural customers.

We've been fortunate, I think, because of our focus on the small and medium-sized businesses that we've -- while we've certainly seen the deposit pricing pressure that others have, in particular, because of credit unions, a lot of credit unions in our market that are very aggressive on the pricing side and because of some of the internet players and not the, just the traditional internet players, but Goldman Sachs with a lot of our private banking customers is very competitive on the money market side, but at the same time, we've been able to continue to acquire a lot of transaction deposits as our commercial business has grown, and so our deposit betas have changed, but have not changed as rapidly as others have, but I think like all of us around the table, we're certainly not just focused on the cost of funds, but on the appropriate emphasis on liquidity, but also, and I know we'll talk about it later today, some of the definitions of liquidity and some of the definitions of high volatility deposits and how high costs of deposits might affect some of those definitions. And as a bank with 103 percent loan-to-deposit ratio certainly looking forward, that would concern us.

I think -- I think that we're certainly advantaged being in a metropolitan area, wealthy suburban area from a talent attraction standpoint compared to some of my colleagues around the table in more rural areas, but I would say that we have the same competition for young talent when we look at long-term succession planning.

And one of the things that our greater size has afforded us the ability to do is that this year, we've actually restarted a commercial training program and concluded, like others around the table, that we can't really continue to rely on attracting very expensive, albeit, experienced talent from some of our competitors, but it's much too new an initiative to determine whether or not it'll be successful.

I don't think that we think we're going to be able to go back to the '80s, but we're hoping to be able internally grow a little bit more of our talent. And that's it.

CHAIRMAN McWILLIAMS: Okay. Thank you.

MEMBER MENON: Good morning. I'm Arvind Menon from Meadows Bank. We're headquartered in Las Vegas. We've got a couple of branches in Reno. We also have a branch in Phoenix, Arizona.

As well as we do a significant amount of SBA lending around the country and we've got about six LPOs in five western states going all the way far as Texas and California and Oregon and Washington.

Nevada has always been a boom and bust state. Things can be looking rosy at one time, and very soon, you hit the depths. The Great Recession was no exception as we were hurt badly. Some say we were ground zero for the Great Recession. That may or may not be true.

Hearing, you know, some of your talk, you lost a lot of banks in your markets as well, so we are no exception from that standpoint, but our economy has been pretty much, not diversified enough if you will. That's been the problem in Nevada.

The primary drivers have been gaming, tourism and construction. And all three of them have pretty significantly affected construction to begin with during the loose lending standards. I believe most of the home builders and office builders felt, build it and they will come, and that philosophy soon turned out to be wrong.

And when the recession hit us, people stopped building, you know, offices laid vacant. Office vacancies were as high as 25 and 26 percent, and so it was really a lot of, a lot of pain along in every corridor if you want to look at it from that standpoint.

Reno was hit hard earlier because Indian gaming or gaming in tribal areas took over some of the gaming out of Reno, and people could stay in California and not have to come all the way to Reno to gamble, and so Reno, we noticed even earlier before the Great Recession hit us, and we’ve had to kind of change our economic base, if you will, and consequently, there's been a little bit more diversification of the economy.

The recovery really started about six or seven years ago. And since then, it has been a pretty steady upward curve with all of the indications being that the economy is still going strong. Vacancies are down. Office vacancy is down to about 15 percent, which is high by many standards, but when I said -- what I said earlier was 25 percent occupancy -- vacancy I should say, so compared to that, there's been a lot of progress.

In-migration has always been strong. Being part of the Sunbelt states, retirees have come in, into Nevada mostly from the Midwest, and more recently, a lot of people from California. We love California because California just drives people and businesses out of that state.

(Laughter.)

MEMBER MENON: And properly being situated next to it, we are a big beneficiary of that. We get a big significant number of businesses relocating, especially into the Reno area, and some to the Las Vegas area as well.

As you might have heard, Tesla, the electric car manufacturer, put a factory in Reno. It's a 5.5 million square foot building and it's supposed to grow to about 10 million, so we'll see how big it is. It's huge.

Now, Tesla has had their own problems lately, you've all heard about that, so we'll have to see how that goes, but the battery factory that is what's built there is a lithium battery factory, so, hopefully -- and Panasonic runs it, so there's going to be demand for that. And I'm sure even with Tesla's problems, it's not going to go away anytime soon.

On top of that, we've had Apple, Google, Amazon. They're all building distribution centers and data centers and what have you.

I don't know if you've heard of Switch. Switch is a huge data center facility, and they also have a co-location facility, which a lot of the backroom IT operations need as a co-location site, so that's another big, big draw in Reno.

In Vegas, as you know, we got our first NHL expansion franchise last year. We went all the way to the Stanley Cup. And sorry to say, we lost to the Washington Capitals, so hats off to you guys here locally.

In 2020, we're expecting the Raiders to move. I know Louise is sad to see them go, but we're looking forward to that, so we're building a new stadium for them, 65,000 square foot -- I mean, not square, occupancy stadium, practice facilities, all of those that go with any NFL facility that comes in, so it's driving business significantly.

Lots of businesses are moving in, ancillary businesses, not just for the professional sports side, we're also seeing professional business services moving in, health and educational services. All of those are growing, so we're expecting that the diversification of the economy that has started in a modest way, it's going to be a while before gaming gets taken over by some of these other things, because gaming is a 600-pound gorilla and it's going to be a long time before gaming will be supplanted by some of these other kinds of businesses, but it's still a good plan to see happening.

Our challenges, like anything else in the room here today we heard about, is continuing to find affordable housing. Housing is a problem in Nevada. Now, the average or the median home price in southern Nevada is $300,000 as of September of this year. That's still lower than what it was ten years ago.

When the recession started in 2005, I think, inflation-adjusted that it would be $391,000, so it's still lower than that, but when you think back 15-20 years ago, people moved to Vegas because the cost of living was cheaper.

You could buy a decent home for about $150,000. It's not the case anymore. And especially when you see a lot of these -- the new job growth has not been in the construction as much as it's been in the service businesses that don't pay as much, and so it's a challenge.

Given the cost of building homes, as we've heard from around the table, land prices in Vegas have gone up from 100,000 an acre to about 500,000 an acre now. Labor costs have gone up, because the construction labor is getting more expensive, and material costs have gone up. This is even before any of the tariffs that are being talked about now is going to have an effect on the cost of building, so given all of that, it's going to be a challenge.

And how we -- how we work through that is yet to be seen. There's a lot of multifamily housing being built, a lot of rentals. I think -- you go around Vegas and you see apartment complexes cropping up all over the place.

And the reason is, number one, the affordability of single-family homes is low, and number two, the people who have probably had to have a short sale in their history are not able to qualify for a mortgage, so they're forced to rent for the time being, and so apartment complexes are doing well. Their vacancies are low and are doing well.

The last thing I want to talk about challenge-wise is finding skilled workers in Vegas. Skilled workers, especially in the construction field and even the professional side, are few and far between, and that is going to continue to have an impact on the way the city grows, as well as in Reno.

Reno is almost impossible to find good people. All of the IT guys are moving in from the Bay area and they're finding it hard to find qualified people to staff all their functions.

Having said all of that, Vegas is still a good proposition. It's got a good climate. It's got the cost of -- cost of living index is pretty reasonable. Business-friendly, so businesses do want to move into Nevada. We have no personal income tax, so that continues to drive the economy.

And last but not least, Vegas must be looking good because the FDIC just recently approved a charter. For the first time, a new bank will be opening in the next few months in Las Vegas since as far back, far back as 2010.

We opened in March of 2008. We're going on 11 years now. We've grown about $8 million in size. It's about time we got another bank in town. Thank you.

MEMBER HANRAHAN: Good morning, everyone. My name is Dave Hanrahan. I'm President of Capital Bank of New Jersey. Let me start by saying, Chairman McWilliams, my compliments on adding this feature to the meeting agenda. I've enjoyed listening to my colleagues and I'm sure the FDIC will benefit as well.

Although, Chad, I got to tell you, following 12 intelligent esteemed colleagues is leaving me, Danny, and Joe precious little really to say, so perhaps next time, you could reverse the order.

MR. DAVIS: I'm going to start the other way.

MEMBER HANRAHAN: Yes, we appreciate that.

Capital Bank of New Jersey is a $500 million commercial bank headquartered in South Jersey just southeast of Philadelphia, Pennsylvania. We're privately held. Have about 450 stockholders. We're a state nonmember bank.

And our model is a classic community bank model. We're a commercial lender and we gather local deposits. Overall, it's a really good time to be a community bank in my opinion.

Asset quality is so good, probably unsustainably good. Business owner and consumer confidence is up, and we're the beneficiary of a big income tax cut that we all got on January 1st, so we're on track to post the best results we've ever put up in our 11-year history.

That said, the topic I'll focus my comments on are deposits, and many of my colleagues have done that already this morning. I find myself spending more time focused on the right side of my balance sheet than I have in my 11-year history.

We all think we have loyal depositors, but then that loyalty gets tested when rates go up, and I'm no longer offering the best rate that they can get. And we're having to spend a lot of thoughtful energy on managing that in the best way, and, unfortunately, saying goodbye to some depositors when we just can't rationalize what they're being offered elsewhere.

There's nothing the FDIC can do about market effects on that, but I am really glad to see that on today's agenda is the subject of liquidity and national rate caps. Thank you for putting that on the agenda today.

I've heard more about national rate caps from my colleagues than ever in the last nine months. And I'm no mathematician, but it seems to me there's something flawed about the way that calculation is performed today.

I know that national rate caps per se only apply to banks that are less than well-capitalized. Nevertheless, I -- I feel like it's trickling down to well-capitalized banks. And I've got a safety and soundness exam starting in a couple of weeks. I expect to have a lot of focus on liquidity and the, the higher cost funds that I might have.

And I've got to manage -- we've all got to manage our funding sources smartly and thoughtfully, but I do need to be able to pay higher rates in certain cases to customers to retain those clients, and it seems to me that some of the national rate cap-driven math is causing those good, local, loyal depositors to be looked at a little differently than I think they should be, so I understand that FDIC will soon be seeking comment on the national rate cap, and I will be commenting on that.

Thank you for looking afresh at that, at that topic, and I'm looking forward to this afternoon's presentation on that. Thank you.

CHAIRMAN McWILLIAMS: See, you managed to add something after 12 people.

(Laughter.)

MEMBER KELLY: I'm Danny Kelly. I'm President and CEO of Hometown Bank of Alabama in Oneonta, Alabama. Just we're a rural bank about 45 miles north of Birmingham. We have a very diversified workforce.

And our primary customer is wage-earning people, small -- individuals and small businesses. We do quite a bit of real estate lending in, you know, owner-occupied homes. One to four carry those on our books and has been a real income generator for us over the past seven, eight years.

Interesting story about -- I mean, I hear all these stories about deposits. We did a CD special for the first time in, I think, we looked back, it was eight years. And the biggest issue was the system, how do we do this? We forgot how to do this.

(Laughter.)

MEMBER KELLY: And, then there was that whole litany of discussion about how to discuss it with the customer. And I said, well, you know, it's a special. Everybody has one now. It's like a 12-month CD. It's a special. It's what everybody has.

So, it was really interesting to kind of take a step back and say, wow, it's been this long since we've had to do anything as far as liquidity is concerned, because, you know, we were at about 65, 68 percent loan-to-deposit. Now, we're at about 83 percent.

We purposely let some high-cost stuff run off. We didn't try to compete. I think that that rag is dry now, and we're going to have to really get back in the business of raising deposits.

We do -- I mean, we're just your, you know, textbook community bank. We raise money from our depositors and we do, you know, occasionally use the home loan bank depending on what the demand is or the need is, but other than that, you know, that is our source of funding, and I think that's going to be our biggest challenge coming up is how to manage that right side as David was talking about.

But we got about 44 percent of our market share where it -- our county is about 50,000 people, so Alabama has been fairly aggressive about incentivizing businesses to come there. And workforce development is a big issue, and it's one of those things that they spend a lot of money, you know, doing that and continue to pour money into that, so I think we're -- I have discussions with people all the time.

The only thing you know about Alabama is the football team or unless they drive through there on the way somewhere and that's basically it. I doubt they're going to the coast today, but, you know, somewhere down in that general area anyway.

But, anyway, I don't have a whole lot. I'm with David. I'm at the end of the table, so I'm going to make it real short, but, again, we -- our bank is close to 15 years. In fact, 10 days, it'll be 15 years old, so the crisis was a lot of fun, but, you know, we did learn some things from it, and I appreciate the opportunity also to serve. Thank you.

CHAIRMAN McWILLIAMS: Thank you.

MEMBER TURNER: Okay. Thanks, Danny. And I'm actually at the very end of the table, so -- and whatever there was to say, David and Danny finished it up, but I'm Joe Turner. I'm CEO of Great Southern Bank. We're headquartered in Springfield, Missouri. We're $4.6 billion.

Kind of our legacy operation has been in Missouri. We have operations in Springfield and Kansas City and St. Louis and then throughout rural Missouri as well.

We purchased five banks from the FDIC during the last crisis. They had operations in Des Moines, Iowa. It's been a good -- it's been good for both parties. Des Moines, Iowa, Sioux City, Iowa, the Quad Cities in Iowa, Twin Cities, Minneapolis/St. Paul. We have loan production offices in Dallas, Tulsa, Atlanta, Georgia and Denver.

And I would echo many of the comments that have been made. You know, I think the economies in all those areas are strong, you know, they remain strong. I would say maybe activity has slowed just a bit, and so I think we're at a dangerous point. Other folks have alluded to this.

I think, you know, people are used to, like John said, 15 percent growth rates, and it's harder to get, and so, you know, what do you do? The banking industry seems to compete on loan proceeds. In other words, how much will you loan, what's the price, and what's the guarantee structure?

And, so, I think in certain markets, Minneapolis/St. Paul probably being one of them, extremely aggressive there, you know, and maybe some non-traditional competitors, credit union competitors, and some others, but I think all our markets, we're seeing a little bit more competition.

I think, as some of the speakers have alluded to, labor availability is going to be a constraint on continuing economic growth. I was visiting our banks in the Twin Cities about a month ago, and they mentioned that a large grocery store chain was looking at opening a sizeable grocery store or two in kind of what they described as a second-ring suburb of Minneapolis/St. Paul, so relatively near to the, the central business district.

And they concluded there's not enough available workforce to make that make sense, so they decided not to do that. And I think that's happening elsewhere too.

We -- we have a pretty large industrial

customer, a customer that develops industrial property, and those folks have told us their biggest -- the biggest thing they look at is workforce availability when they're buying a ground. It's not road access. It's not necessarily geography. In other words, central part of the U.S. or whatever, it's what's the availability of qualified workforce.

Like everybody, our loan-to-deposit ratio is over 100 percent, so I'm also encouraged that we're going to be talking about, you know, brokered deposits and other things. I think, you know, we've had brokered deposits on our balance sheet for a long time, and so just an advertisement for it, I think it is a quality alternative funding source that banks should be able to use.

You know, I realize, I think, the FDIC has done a study that showed that, you know, many of the banks that failed had brokered deposits, and I would suspect that's true. I'm not sure there was causation between having brokered deposits and failure. It's more -- it's more an issue of what you do with the deposits. Whether you -- whether you bring deposits in in your local market or you get them from a broker, if you make bad loans with them, you're going to have a problem.

And, you know, I just think, you know, for us as we think about raising maybe $100 million in deposits, you got two ways to do that. You can go -- or lots of ways to do that, but, you know, you can, you can borrow money from brokers or you can risk repricing your entire $4 billion portfolio, so as you raise that $100 million, if you re-price your entire portfolio, the marginal cost of that is extremely high, so, you know, I'm glad to see that we're going to be talking about that. I think, you know, that a really even-handed approach by the FDIC to brokered deposits, you know, would be a very good thing.

Interest rate risk, I think, we're like most of the industry is seeing higher beta factors. It was interesting in our last ALCO meeting, we had, you know, kind of an expert talking to our ALCO committee, and this person said that the last time rates came up like in 2004, they rose 425 basis points. Beta factors during the first 100 basis points were 8 percent, during the next 100 basis points were 25 percent, and during the third 100 basis points were about 100 percent, and, you know, that's kind of what we're seeing, and, I think, that's what the industry is seeing.

You know, we haven't had the third 100 basis point yet, but the first 100 was about 8 percent beta factor. We've had 25 or 50 since then, and I think it has been about 25 percent, and so, yes, I think increasing beta factors are, you know, going to be a fact going forward.

We're starting to look at -- I mean, we're asset-sensitive, which has been a good thing, but, you know, we've heard many of the people say the economy is going to turn, and when the economy turn, rates are going to turn down, and we're frankly not as well positioned for that, and so we're trying to, you know, think about maybe how do we take a bit of our asset sensitivity off the table to better prepare for, you know, what we think inevitably will be, you know, rate declines.

And when rate declines happen, you know, you start seeing generally a weaker economy. They happen as a result of a weaker economy, so you're going to see more credit costs, maybe less economic activity otherwise, so you don't want to have a compressed margin on top of that, so we're focused on that.

That's all I have.

CHAIRMAN McWILLIAMS: Thank you. This is great. Thank you. I joke that I have to go around the country to solicit this type of feedback, so this is remarkable that we are able to get a very diverse perspective. And I know you felt like you were at the end of the table, but I guarantee you, this side added as much as this side, so thank you very much for that.

MR. DAVIS: We actually have, amazingly, a couple of minutes left. Usually, I'm going to be the guy cutting things off, but we can just go to the break, but I thought I'd give folks the option first if there was any questions that folks had as they were listening to peers. If there's any topic that they want to discuss, again, we got a couple minutes just thought I'd give people the option.

CHAIRMAN McWILLIAMS: I actually have a question. Some of you mentioned exiting mortgage originations. Can you just raise your hand if that's an issue for your bank?

MEMBER SCULLY: We haven't exited, but we've cut it by two-thirds.

CHAIRMAN McWILLIAMS: Okay. Okay, thank you.

MR. DAVIS: Okay. Well, if there isn't anything else, we've got a break then until 10:45, so feel free to grab coffee, water, make some calls, check some emails and we'll meet back here in about 15 minutes. Thank you.

(Whereupon, the above-entitled matter went off the record at 10:27 a.m. and resumed at 10:52 a.m.)

MR. DAVIS: Okay, now we're going to provide the committee an update on several supervisory issues. From our Division of Risk Management Supervision, we have Doreen Eberley, the director, Rae-Ann Miller, an associate director, who oversees the risk-management policy area, Ryan Billingsley, a corporate expert on capital markets, and William Henley, an associate director of our Information Technology Supervision branch. I'll now turn the program over to Doreen.

MS. EBERLEY: Thanks, Chad. So, we've been busy the last few months, since we last met, in Risk Management Supervision, and we're going to talk about a number of matters this morning that we've been working on, some of them addressing implementation of aspects of the Economic Growth, Regulatory Reduction, and Consumer Protection Act, signed in May of this year, and others that address information that we've provided to the industry.

Rae-Ann's going to touch on the role of supervisory guidance, notice of proposed rulemaking on reciprocal deposits, examination frequency, and retirement of a large number of financial institution letters. Ryan's going to talk about the notice of proposed rulemaking, relating to the definition of high-volatility commercial real estate, or HVCRE, exposures. And William's going to cover the issuance of two new cyber challenge vignettes, as part of the FDIC's technical assistance video program, as well as an FFIEC resource guide. So, I'll turn it over to Rae-Ann to kick us off.

MS. MILLER: Thanks very much. And in your packets, you should have a pretty hefty stack of stuff that we've been working on. So, as Doreen mentioned, we've been very busy. I'll just probably go in order of that stack, just to make it a little easier, but really in no particular order of importance.

They're all important, but I guess, most recently, my group has worked on an interagency statement that clarifies the role of supervisory guidance in our examination process and our supervisory process. And this was an area where there has been some confusion and some concerns that examiners were applying guidance as if it were a regulation, as if it were something that were binding, and that's never been our policy and never been our process.

So, you might not realize this, but in July of 2016 -- some of you folks were on the committee at that time -- we did, our board, issued a statement to us on developing and reviewing supervisory guidance that basically indicated, you know, guidance is not a regulation, but is an important piece of information, is an important framework for risk-management practices, but is not a binding document.

But on an interagency basis, we very recently issued a very similar statement to reinforce that message for the public and for examiners. And it basically talks about the fact that, unlike a statute, unlike a regulation, that guidance is not binding, and examiners will not indicate that a bank is in violation, so-called, for not following a guidance document.

You should know as well that we have been working with our examiners on training, on reinforcing this message. I personally, with my section chief, have been out to every region, training our commissioned examiners and reinforcing that message in the earlier part of this year.

So, should I just go through them all and then hold questions? Would that make sense? Okay.

So, the second one that I'm going to talk about, we touched on a little, and I know Dave is very interested in our conversation this afternoon. But we issued a notice of proposed rulemaking regarding the treatment of reciprocal deposits. And Tiffany was interested in this, as she mentioned.

So, we issued this NPR on September 12th, and basically, this is a conforming regulation. There were some changes in the new law. I can never remember the name of the new law, so we call it S.2155.

And so basically, the changes we made in our NPR were to conform Section 29 of the Federal

Deposit Insurance Act to the new law. So, what the NPR does is it basically incorporates a definition from the act. And what that does, it accepts a capped amount of reciprocal deposits from being treated as brokered deposits for certain insured depository institutions. And that cap, just as a reminder, is the lesser of either 5 billion dollars, or 20 percent of total liabilities. And a special cap also kicks in if the institution is either not well-rated or not well-capitalized. And that's a little tricky, but that cap gets calculated based on the average of the last four quarters before the institution either became less than well rated or less than well-capitalized.

So, basically, it's a conforming type of notice. It was published in the Federal Register on September 26, and the comment period is open through October 26. I think more interestingly, perhaps, in the NPR we announced that we are going to be -- this is the first of two parts of a broader rulemaking effort, where we're proposing, or we're planning, rather, to seek comment on a broader range of issues later this year, on the overall brokered deposit regulations.

I mean, as you know, the law, with respect to brokered deposits was first put in place in 1989. We're going to talk about a little bit about it more this afternoon, but first, from the last crisis in 1989, and it was amended in 1991 and basically tied to the PCA, Prompt Corrective Action, framework.

So, it's certainly been a while since the law has been written. I was very interested in your conversations this morning about really how the deposit market has changed, and continues to change. And David and I were just talking a little bit about that at the break. So, very interested in your thoughts on that. And we certainly encourage comments on the broader rule later this year.

So, that's reciprocals. I will move on to the next one, which I believe is exam cycle. So, the new law also extended the 18-month examination cycle for certain institutions. And as we did the last time the law was changed, we issued an interim final rule to make the law immediately -- or, the law was immediately effective for one-rated institutions, but to make that change immediately effective for two-rated institutions, which we must do via regulation.

So, basically, for qualifying one- and two-rated institutions with assets up to 3 billion, they are subject -- or, eligible for the 18-month exam cycle, provided they're well-managed, well-capitalized, not subject to enforcement action, not subject to a change in control.

The interim final rule is going to increase the amount of institutions eligible for the cycle by about 420 institutions. So, that brings the total number of eligible to 4,798. So, that's the vast majority of all institutions would be subject to the extended examination cycle. And just as it is with the existing regulations, we still have significant flexibility, for safety and soundness reasons, to examine more frequently if it's necessary.

So even though that's the interim final rule, we do accept comments on interim final rules. We got one comment on the last one. It's a great job, guys. Which is great. So, that's awesome. So, we're accepting comments up through --

CHAIRMAN McWILLIAMS: We took that one seriously.

(Laughter.)

MS. MILLER: Up through October 29th. But we have already implemented that change in the field, so maybe some of you, I heard about what your asset sizes are. Maybe you've benefitted from that.

And finally, I just wanted to touch --

MEMBER TURNER: Excuse me, do you happen to know -- So, the rule is, if you're less than 3 billion, is that right?

MS. MILLER: Yeah.

MEMBER TURNER: So, do you happen to know, during the last crisis, what the dollar amount of losses the insurance fund suffered from that asset range? You know, institutions 0 to 3 billion?

MS. MILLER: I do not know that number off the top of my head.

MEMBER TURNER: I didn't think you probably would.

MS. MILLER: They are costly, they are costly.

MEMBER TURNER: They -- Yeah, but I'm sure it was, even though there were a lot of those institutions that failed, they just don't have as big an impact when they do fail. So, I'm sure it was relatively small, compared to the overall loss that the insurance fund took.

MS. EBERLEY: Zero to ten was about 40 billion, out of the 70 billion total.

MEMBER TURNER: Okay.

MS. MILLER: Those failures can be costly.

CHAIRMAN McWILLIAMS: So, please don't fail.

(Laughter.)

MS. MILLER: Okay, the final release

that we issued was we proposed to retire a pretty wide swath of our financial institution letters and move them to inactive. So, this kind of started, this review of our financial institution letters started back in March of last year. In our EGRPRA report, which we briefed up to this group many times, we committed to looking at our guidance documents and looking for ways, even though it was outside of the EGRPRA process, but looking for ways to reduce burden there.

So, we view this look at our FILs as sort of the first step in that process. So, we looked at our risk-management FILs. We have other parts of the agencies also issue financial institution letters, but we in RMS are by far the most popular users, the best customers for public affairs, if you will.

And we identified 374, out of 664, between 1995 and 2017, that we felt were either outdated, or you could find the information elsewhere that lives on the website. So, we have proposed to retire them. And when we say retire, it doesn't that you can't find them. I mean, they do still live on our website, and they'll have a retired label, archived label, whatever it's called.

So, we proposed to do that. It's interesting because we did issue that for comment, and we have gotten some comments, which I thought we would. And oftentimes, it's from people who just can't possibly live without something.

And so, we're trying to do a better job overall in organizing our website and in communicating. You may have heard the chairman talk about communication and transparency is an important thing. But a better way to do that so people won't be so reliant on the FIL.

The FIL was never intended to be a standalone communication or standalone document, but more of an envelope to communicate various things. So, we're sort of trying to break that reliance factor on FILs. They were never really intended to be a permanent document. So, I think that is my things. And we could turn it over to

Ryan, or we can ask questions.

MEMBER SCULLY: So, you're saying that every industry has its hoarders, is that right?

(Laughter.)

MS. MILLER: You said that, Mary Ann, not me.

(Laughter.)

MR. BILLINGSLEY: So, next up, Ryan Billingsley.

MS. EBERLEY: Dave did you want to --

MEMBER HANRAHAN: Yeah, I do, if you don't mind Ryan.

MR. BILLINGSLEY: Yeah, sure.

MEMBER HANRAHAN: Thank you. Rae-Ann, a comment on the document that's out for comment on reciprocal deposits. One of the questions posed in there is, how should de novos be treated, with respect to reciprocal deposits. And even though my bank is no longer de novo, it's a fresh memory, and I still have a soft spot in my heart for that.

My understanding of the issue is, as the legislation was written, it pertains to banks not well-rated. If a bank is not well-rated, that's an issue for reciprocal deposits. And de novos, by definition aren't well-rated because of their newness. I'll use a line that I hate when my kids use on me. That doesn't seem fair.

The de novos have done nothing to earn a not-well-rated status, and reciprocal deposits take just as long to cultivate and foster with customers as any other vanilla deposit account. De novos have sometimes an added burden of convincing their market that this brand new bank is a safe place to put their money. So, the reciprocal aspect could be very valuable to a de novo in its early days, and it just doesn't seem right to me that a de novo would be ineligible to use reciprocal deposits, simply by virtue of its newness.

So, I will be submitting a comment letter -- and I'll say it better than I just did -- in that regard before the October 26th deadline.

MS. MILLER: We look forward to that

comment letter, David. But I will say that --

CHAIRMAN McWILLIAMS: I think you just need to block David's address, because he's submitting a comment letter on everything.

(Laughter.)

CHAIRMAN McWILLIAMS: No, we encourage you to. Please do. It would be immensely valuable to us if you could provide comments on this.

MS. MILLER: And just to correct something that you said, it's not that they wouldn't be able to use them. They would be able to use them, but they would need to report them as reciprocal. I mean that's -- As brokered, rather. Yeah, as brokered deposits. So, that's the issue.

But that's a very good point, and I don't know that the drafters had thought about --

MEMBER HANRAHAN: And they're probably not allowed, under their new business plan, to use brokered deposits.

MS. MILLER: That, I don't know. It depends.

MS. EBERLEY: Yeah, de novos typically have some amount of brokered deposits in their business plan.

MS. MILLER: I guess it depends on that thing. But you made me think of another thing too, David. One of the other aspects of this law is that the reciprocals can't come through a third party, so they have to be that cultivated with --

MEMBER HANRAHAN: True, right. That makes sense.

MEMBER HARTINGS: Rae-Ann, if I could just make a comment about the exam cycle. And this is kind of the thought process. You know, you talk about I think 420 banks now will fall underneath the new exam 3 billion dollar cycle. You know, I hate to say it's a win-win, but even if you look to losses that we've sustained, one thing it gives you is it allows you to concentrate your effort on those banks that are less than one- and two-rated, which is what you need to do.

And I'm a 500 million dollar bank, and I'm already looking at a billion or a billion and a half, so does that make my strategic planning a little bit better going down the road? And what I mean by that is, if you can keep regulatory thoughts in long-term planning, I'm a 115-year-old bank. All of our banks here have been around a long time. We talked about succession planning and getting people on-site, and the right workers.

About eight years ago, we started a management training program because we were having the same issue. I didn't benefit from that for the first five years. Now, the last two-three years, it's starting to benefit. And I think this exam cycle is the same way. We see our banks getting larger, so let's build a plan that's good for you, good for our oversight, but also doesn't restrain that growth of community banking, because I think as you look forward and say, well, we'll do this, but what happens if we get a little bigger?

And so, I mean, I think it's great that you're expanding that, but kind of think of that thought process. It's, what will that do for us five years from now or ten years from now, not what will it do for us today. Because, unfortunately, a lot of our regulation is reactive, and I think that planning is what -- I think everybody around this table sits and does a great amount of planning, and they don't look out next year, they look out five years or ten years. So, I think that's a real positive for everyone.

CHAIRMAN McWILLIAMS: Thank you.

Before we move to Ryan, Mark, will you just give us the number of the consumer FILs we're looking to retire, as well.

MR. PEARCE: Sure, I can do that from here. You all can hear me. So, we have somewhere in the neighborhood of a hundred and seventy-something FILs on the consumer side. And we think we'll be able to retire somewhere in the neighborhood of 112, I think is the number. So, about 63 percent of the FILs related to consumers will be inactive as a result of this process.

CHAIRMAN McWILLIAMS: Thank you.

MS. MILLER: One more correction before we move on. It's not that de novos are not well-rated, they are not --

MEMBER HANRAHAN: Apparently I made a lot of wrong comments.

(Laughter.)

MEMBER HANRAHAN: Go ahead, pile on, Rae-Ann.

MR. BILLINGSLEY: Sorry to cut you off, I was so excited to talk about HVCRE.

So, why don't we go there? So, the last time we were together, we talked a little bit about the capital aspects of S.2155, and I wanted to give you an update on what we had done on HVCRE. So, it'll be very brief. I'm happy to take questions.

We issued a notice of proposed rulemaking with the Fed and OCC on September 18th. The rulemaking really only does two broad things. Number one, it just aligns the definition of HVCRE, or High-Volatility Commercial Real Estate, in our capital rules with that that's in the statute. That's pretty straightforward.

And number two, the reason it's a proposal is that we want to get feedback on that definition, to sort of do what we can do to make it clear. So, if there's areas of that definition that need additional clarity, we want to hear from you so we can get it right.

One of the things that we had a problem with, with the HVCRE definition in the old regulation, was this inconsistent application idea, right? So, I think that that's the aspect of this I would focus your attention on.

In the meantime, so while we work through the NPR phase and collect comments -- by the way, comments are due on that proposal on November 27th. While we work through that process, you are permitted to report HVCRE on your Call Reports, using the statutory definition. So, don't feel as if you have to use the reg definition. If you want to use the statutory definition, please do.

It's a best-efforts basis. We realize that, as you collect information on these loans, that might change how you categorize them in a future period. That's okay. We're not going to ask you to refile old Call Reports because you have new information in the future.

So, that's something I wanted to definitely mention, as I'm not sure a lot of institutions are aware of that. I went through some of the key differences of the statutory definition last time we were here, so I won't really do that. But I will say that the construct of the definition is largely similar to what it was in the old regulation.

The scope is slightly changed, and some of the exemptions, how you can classify a loan as not HVCRE are changed. So, if you're a bank that does ADC lending, I would definitely focus on that. It might behoove you to pay attention to that, but I won't go into the gnarly details of that definition. But I'm happy to take questions on that and on any other capital issue.

MEMBER SCULLY: So, Ryan, I have a question that's come up recently. And you've just alluded to the ADC lending, and that is that there has been some discussion, and we haven't been able to get clarification as to whether this is true or not, that 1 to 4 family now might come under the umbrella of the HVCRE, if there's a certain number of lots available.

And my reading of that is, no, they're just clarifying that 1 to 4 is 1 to 4, not five, but some people are interpreting that to say, if it's a larger subdivision, if it's more than five. And then the question is it more than five spec, is it more than five in total? So, maybe the general question would be, to your point about look at ADC, does some 1 to 4 now come under the umbrella of HVCRE?

MR. BILLINGSLEY: So, under the old definition -- It's a great question -- under the old definition, it would not have. Under the statutory definition, the definition just says, 1 to 4 family residential real estate is excluded. Well, the question is, "What does that mean?" So, that's the purpose of the proposal is to get feedback from you all on, is that consistent with how you report on the Call Report? How do you use it in your Real Estate Lending Guidelines, your policies and procedures?

MEMBER SCULLY: We look at the dwelling. We don't look at how many dwellings there are. We just look at the dwelling.

MR. BILLINGSLEY: What I would point you to is, the 1 to 4 is really getting at, is it single-family or multifamily, right? So, if you have an apartment building that has five or more units, that's in the multifamily space, right? If you have single-family dwellings, that's in the 1 to 4 family space.

So, a lot development loans to construct a small subdivision is likely going to be excluded in the 1 to 4 family exception. Again, the purpose of the rule is to make sure that we get feedback from you on how you're going to categorize that and what the risks are, and to make sure that how you report that to the system with other regulations as well. Consistency with other regulations is kind of a big deal with this one. Is that helpful?

MEMBER SCULLY: Yes.

MR. BILLINGSLEY: Okay.

CHAIRMAN McWILLIAMS: I think David may have to submit one more comment on this.

(Laughter.)

MR. HENLEY: Well, good morning. My name is William Henley. And thank you for the opportunity to inform you about two coming attractions from RMS's Operation Risk Group. So, the first update is to the FDIC Cyber Challenge, a community bank cyber exercise.

So, practicing your response in the face of an operational incident is key to an organization's resiliency, should an incident actually occur. Post-incident critiques often confirm that experience gained during exercises provides the best way to prepare organizations to respond effectively to an emergency.

Effective exercises are designed to engage team members so that they can collaborate in the management of a response to a hypothetical, yet possible, incident. Exercises enhance knowledge of plans, allow members to improve their own performance, and identify opportunities to improve capabilities.

In 2014, the FDIC published for the first time four scenarios that a community bank could use to exercise their business continuity plans. We added three more scenarios in 2015, and this month, we will release an additional two scenarios, bringing the number to nine scenarios that are available.

Each scenario is supported by guidelines for conducting an exercise, a video that walks through the scenario with actors, and challenge materials that describe the scenario and include questions that can be used to think through how your bank would react in the scenario.

Just briefly, I'll go through the scenarios that are available today, the first seven that were released. The first is an item-processing failure. A new item-processing service provider cannot process the volume of transactions generated by the bank.

Customer account takeover is the second scenario. A corporate customer reports unauthorized withdrawals on its account.

The third is a phishing scam. Bank staff receive a phishing email that appears to have been sent by the institution's president and causes disruptive malware to be introduced to the bank systems.

The fourth is a technology service provider problem. It is occurring as a result of a system update.

The fifth is DDOS, or a Distributed Denial of Service attack. The bank IT manager investigates a possible DDOS attack and discovers a second attack that steals data from the institution.

The sixth is ATM malware. ATM malware reveals deficiencies in the bank's service provider contract.

And the seventh is ransomware. A cyber-attack has taken place, and important files are being held for ransom.

So, all of the scenarios that are currently available are based on actual incidents. The two new scenarios are natural disaster, a flood. Operational problems ensue after the bank status center and their telecom provider's operations are flooded.

And a supply chain incident. A third-party software update infects the bank's systems, disrupting core processing, and breaches sensitive data.

So, by the descriptions that are provided, we see that these are current and applicable to the environment today. We chose to add these two new scenarios because recent incidents that remind us of the higher probability of these types of incidents are actually occurring.

And the first scenarios are currently available on our public website, fdic.gov, and the two new scenarios will be added shortly. They should be out this month. And we hope that these resources are helpful to community banks, as you test your business continuity plans. And we continue to welcome your feedback on these scenarios.

The second release is October, for the last fifteen years, has been designated as National Cybersecurity Awareness Month, which is an annual initiative to raise awareness about the importance of cybersecurity. The Federal Financial Institution Examination Council, or FFIEC, is hosting a cybersecurity webinar on October 31st. And we're also publishing a new cybersecurity resources guide for financial institutions.

Webinar registration materials will be sent to you via FDIC connect, and they should be out shortly for registration. So, it's an industry-only, or institution-only webinar.

The webinar will review the programs and initiatives included in the guide, which are designed to help organizations meet their cybersecurity control objectives.

The resources are divided into four types: assessments, exercises, information sharing, and response and reporting. The first page of the guide identifies the 16 cybersecurity resources and whether they're free, or a fee service, or a combination thereof. And the subsequent pages provide an overview of the services, as well as information on how to investigate further.

The intent of this guide is to centralize information about a set of resources currently available from government and the private sector, that can help improve the resilience of the sector. We often hear from community banks that it's hard to know where to start in assessing the myriad of cybersecurity resources available, and we hope that this guide reduces burden on institutions that would otherwise have to complete this research individually. Thanks again for the time to update you on these initiatives.

MEMBER SHETTLESWORTH: Concerning phishing attacks, that's a real issue that we face every day. My question is, when it comes to the FDIC, have you all ever considered what to do with the information whenever someone is emailing us trying to come off as a customer of ours, saying, please send a wire to X bank somewhere else?

Most of the time, we'll delete those emails. Sometimes we'll play along and say, please send us your wiring information. And so we have the account information, the fraudulent account information, at a legitimate institution. It's usually a larger institution or an online bank.

But is there anything that we can do? Because that's the point of fraud, through that account, and I'm just curious, is there any type of reporting we can do or FDIC can facilitate with? Because until you cut it off there, at the new account opening place, you'll never even make a dent in this process. I'm just curious if that's ever come up.

MR. HENLEY: Yes, so, questions like that have come up. In our last alerts on security alerts, one of the things that we have encouraged is participation in information-sharing groups like FS-ISAC. And I know that they compile that information, and I think that the public-private partnership and the provision of FS-ISAC is really where we would encourage you to join and to share that information there, because they do provide aggregated information on those types of threats and do a good job of pushing out to members about those threats.

MEMBER SHETTLESWORTH: Okay.

MEMBER HARTINGS: Have you seen -- we've seen in our area, masking phone numbers. Basically, the technology today, it's kind of like the good old-fashioned way to defraud. They are able to make it look like our bank's phone number, make a call to customers. And I mean, we're seeing that happen a lot in our areas, and now it's starting to move down to texting. Have you heard much of that? We talked to the phone companies. That's a technology that's available out there. It doesn't seem like anyone can do anything about it. But have you heard about that? It's a little bit different than phishing, but it's done over your phones. Have you heard much feedback from the banks on those issues?

MR. HENLEY: You know, we were talking this morning over breakfast that there's no end to these schemes that criminals come up with, because it's important to them, right? It's part of their business model. And so, with that, you know, we've received calls like that, even here within the FDIC, that type of phone masking. And yes, it's just another attack or attack vector that the criminals are using.

CHAIRMAN McWILLIAMS: I got one of those on my work phone, yes.

MEMBER DONNELLY: William, just on those exercises, you said there's going to be seven of them. And we participate in the FS-ISAC payment attacks exercises. It's a couple-day event and two or three hours a day. What do you expect the time to be to run through one of your exercises? Because it is a cost. Absolutely good stuff, but you've still got to apply a cost to that. So, do you have an expectation of time it would take to go through those?

MR. HENLEY: That's an excellent question. So, each of the vignettes, they start off with the video, and the videos that are being released, and the seven that are available and the two that are being released, I believe are all under five minutes. I think that numbers 8 and 9 are like three and a half minutes each.

And then, they come with a set of instructions, or instruction cards, that kind of walk you through a facilitated discussion. So, I think that an institution could set aside a reasonable period of time, you know, an hour or two, or maybe even less, because like I said, the scenario is presented through the video in a three-and-half-minute segment. It's got a set of questions that help the staff to walk through it. So, it's not intended to be a long investment of time.

MEMBER DONNELLY: No, I'm just looking for an idea, because I totally agree with the exercises, because they do open up and enlighten what you need to do in your own shop, and just kind of getting an estimate of time before we get started. I'd hate to get into something and find that one take three weeks or a month to do, and then say oh. So, thank you. That's exactly what I was looking for.

MEMBER HARTINGS: We've done these, and we have about twelve to fourteen individuals in a room, I'd say. You can do two of them in about an hour, a little over an hour. That's about what we planned for.

MEMBER DONNELLY: Thank you.

MEMBER K. KELLY: William, I just want to commend you. This is a very important topic, and it's one that, to be perfectly honest, I think for the CEOs up here, it could keep us up at night, because it's the new form of robbery in this industry. And so, I want to commend you for it. We're going to take it to heart and use the nine that you've put before us.

My question would be, is there a -- I heard the acronym used for the group that's focused on this, but my concern on a broader level would be how do we transfer information without creating a panic when something new happens? And I don't know the answer to that, and maybe I'm just not aware, but, you know, it's an arms race out there, as you and I talked about this morning. The guys are getting just as smart as we are at playing defense on it, and my point is, every time something new happens, is there a way to communicate without creating paranoia and a crisis, such that people can play defense on some of those new methods that they're using?

MR. HENLEY: Certainly. And thank you for the question. And I forgot to mention that acronym. You know, here in D.C., we speak only in acronyms. The rest of the world does not.

So, the FS-ISAC, that's the Financial Services Information Sharing and Analysis Center. And so, it was the product of a presidential directive that set up the public-private partnerships between the 18 critical infrastructure sectors. And so, each sector has an information sharing and analysis center. And so, that member-driven organization that reporting into that organization, into FS-ISAC, is on a noncompetitive basis. It's for analysis for the sector. So, that would be the site or the destination that I would encourage the members to do, is to work with FS-ISAC.

MEMBER K. KELLY: Okay, great. Thanks.

MEMBER TOLOMER: I commend your efforts, but I would also suggest -- I know we do it. I'm sure many of you do as well -- is there are programs that you can purchase, where you can periodically test phishing for your entire employee base. And what we found was, the first go round, we had four or five people that didn't make it. And now, it's very unusual if somebody clicks onto the site. But we make it part of their job responsibilities, and so, if somebody fails twice, they end up having a conversation, being verbally warned for their employment, and continued means that they'll leave.

This is the number one way a bank can protect itself against phishing, and that's the number one thing that happens for cybersecurity. So, it's a very serious matter, and there are programs where you can test yourself, and you'd be amazed that from time to time, people click on a $5 coupon or a $10 coupon just because they can't help themselves. But they begin to learn it's not to be trifled with.

And so, it's the best we way we know how, so I think it's a great way to do this, but I would encourage people to purchase a program that you can test your employees on all the time on an ongoing basis. I think that you were talking about that, Kenneth.

MEMBER K. KELLY: Right, and John, we've used some of that. In fact, we've seen, back to the sophistication, where now, there's the effort that they would use, kkelleyfirstindependence@gmail.com. And so, my point is, the nuances are increasing with the ability to try to figure out how to penetrate. And so, for someone who says, oh, that's Kenneth, he's sending me an email. But really it's not, it's kennethkelleyfirstindependence@gmail.com.

My only point is, as leaders up here around this table, we have to figure out how do we communicate in such a way that if I see that, all of us should see that, so that we can play defense against it, versus having to figure it out on our own. Because by that time, it could potentially be a loss for one of our institutions. That's the only point that I wanted to make on that.

MEMBER EMMONS: I would just, as a point of interest, I would offer that we have a very strong state banking association, and if there's one time when we stop acting as competitors, it's when we have an attack that's perpetrated on one of the banks. And the communications that takes place at the committee level -- so, they have an info security committee or a security committee. And when an attack happens, it's often geographical, and so there's a communications that goes through the state association that tends to be very helpful. So, I think that's one of the areas where you can look for some help.

MR. HENLEY: Yeah, so, the State Liaison Committee and the Conference of State Bank Supervisors are members of the FFIEC. We work closely with the representatives from those organizations. And in the face of incidents or disasters in the past, we've had many lessons learned that we've tried to incorporate, just for example, with incidents that happened at service providers, that now, with the speed of technology, and being able to move across geographic boundaries, that we formerly would only contact those commissioners for the state or states that were affected by an event.

But after lessons learned, we were able to -- we saw that was a blind spot, that we needed to work with commissioners in banking departments more reflective of the customer base, as opposed to the geographic impact. And so, we have a strong partnership with the state banking departments in this area, particularly through those two organizations that I mentioned.

MEMBER PAINE: I do think that, when we talk about disruption, a lot of people focus on the fintechs, but really, if you're talking about spoofing, or malware, or phishing, or -- we had this thing happen to us, spambot. That's crazy. It was just, we had our executive secretary just flooded with a thousand emails in fifteen minutes. And this kind of disruption -- and it's debit card fraud, and it's ACH fraud, and internet banking fraud, and it's not just key loggers anymore. It's so much that I think that the disruption portion of it, the automation has made our life simple, and the disruption has made it twice as hard.

So, not only the cost, because we can't, as a 140 million dollar bank in rural Minnesota, hire an IT person that's going to stay more than a year or two before they want to go to a metro area -- it has created financial and at times emotional, because these are customers. And it's not our employees necessarily. We do the social engineering like we're supposed to do. But it's not our employees, it's our customers. It's our customers that went on their online banking, and went through the two layers of security because their CEO sent them an email to wire funds. And just because we are a 140 million dollar bank, when that wire came through, and we went through and verified, with that customer, hey, did you actually send this wire? They said yes. And we went through our second check internally, manually, and we said, they don't -- this is abnormal. So, we called the president and stopped a $500,000 wire from going out, because we know our customers.

It's not necessarily just us. It's our customers. So, we try to educate our customers, especially the ones with the cash management, we sit down with them on their annual review, when we're going through their contracts. But if some way, the regulators, in a reasonable form, could help assist us to say, these are things that you're liable for -- because guess what. They're not going to take the loss, we are.

We had a $13,000 loss on an ACH file that was somebody used a public computer in Vegas, in Caesar's, signed onto their commercial banking. And guess what, they got hacked. So, we ended up taking the loss on that. Even though in the contract it says we won't, you can't do that in a small town, for a small business.

So, if we can get some assistance, that would be so helpful because there's a liability aspect of that. We're not IT professionals. Neither are you, and I get that. But if we can somehow team up together to get a be safe, you know, bullet-pointed, something that we can either add to the contract, or put in our annual training, or something like that, that would be very helpful for us because, again, our number one risk is our customer.

MS. EBERLEY: We do have, on our website, pamphlets that you can distribute to your customers. We can send around the link.

MEMBER PAINE: That would be great.

MS. EBERLEY: They're graphics-ready. You just download and print. One designed for retail customers, one for business customers.

MEMBER PAINE: That'd be great.

MS. EBERLEY: And we also produced an issue of our consumer news that was specifically focused to cybersecurity hygiene tips and tricks for customers of banks. So, we'll send links to both of those to all of you.

MEMBER PAINE: That'd be great. Thanks.

MS. EBERLEY: Sure.

MR. DAVIS: Anything else on this topic?

CHAIRMAN McWILLIAMS: You had something.

MEMBER WALKER: No, I was just going to say, add, that it's also reputational, because this text alert thing, in a rural community is very impactful because you tend to be the only bank around. So, we end up spending all of our time -- The message went out, and it said, your debit card transaction at First Northern Bank has been fraudulent, please click here. And so, what happens is you're flooded with calls from customers and noncustomers, because they're picking out a whole range of area code and just sending it out, thinking that most of the customers probably bank there. So, it becomes -- you have noncustomers calling as well, and it's just, as you said, a disruption and difficult to deal with when you don't expect it, and you're just sitting there going about your normal day, and then all of a sudden, you get all these calls from customers and noncustomers.

MR. DAVIS: Okay. We can move on to our next panel then. We'll now have an update from Anthony Lowe, the FDIC's ombudsman. He's going to talk about a proposed annual report from his office.

MR. LOWE: Good morning. So, when we met back in July, I provided a brief overview of the Office of the Ombudsman, talked a little bit about our strategies, what we do on a daily basis, some of the major tenets of the office, the types and methods of contacts that we have, and frequently-reported areas of concern from the industry.

And what I'd like to do today is to discuss a method of broadening the awareness of the Ombudsman Office, which is, I think, a very important goal, especially when you consider some of the comments that our chairman has made recently, in congressional testimony, and some of her public statements.

I will want to get some input from all of you as we go through this brief discussion about the proposed annual report that we have presented to you, and get some feedback on you, with regard to the comments that are in there, the format, and why you think it is important.

Why do we think it's important to have an annual report? Well, just a little bit of perspective, from 2004 through early 2014 we did issue periodic reports on the industry to our representatives. It provided some general information, a broad overview of questions that had been presented to the office, as well as some limited elements of raw data on the number, type, and trends of contacts with the industry. And as I alluded to earlier, as you're likely aware from reading or seeing the testimony of Chairman McWilliams recently -- and shame on you if you did not see the testimony.

CHAIRMAN McWILLIAMS: Thank you.

(Laughter.)

MR. LOWE: The FDIC is pursuing an important agenda that promotes trust through transparency, an initiative that aims to expand transparency relative to FDIC operations. My office, in trying to commit to this initiative, is seeking to identify meaningful channels to communicate the services and activities that we provide. And it's our goal that this annual report will complement agency-wide efforts in this regard.

We've done a little bit of research in this regard, and we determined that there's close to 150 federal ombudsman offices around the country, with 44 different government agencies.

Of these, the FIRREAs, the bank FIRREAs, the OCC, the FRB, NCUA, all provide some type of an annual report.

Right now, the only agencies that provide a separate annual report are the Bureau of Consumer Financial Protection and the OCC. The NCUA does not provide a separate annual report. The FRB is in the process of developing a report. They plan to have it issued by the end of this year or early 2019.

There are some other reports that are out there of course, you know, from other agencies, and they do kind of run the gamut. Some of them are all narrative, some of them are nothing but data, a lot of dashboard approaches. Some of them do include trend analysis, and some are nothing more than talking about the responsibilities of the office.

So, the report that we provided to you in the materials for this meeting, if you thumb through it, it just -- just to tell you what's in our report right now, it includes a general description of the office, provides some detailed information on totals and trends, relative to contacts from the industry. It talks a little bit about inquiries and complaints that do come in, the sources of those complaints. And it also talks about the common discussion themes, concerns that are raised by stakeholders, that being the bankers, the general public to some degree, the trade associations, and, you know, the other regulatory agencies.

So, what I'd like to do is ask you, generally, four questions about the report. First off, do you think an annual report would be of value to you and to the industry? What do you like or dislike about the proposed format of the report? Is the information that's presented of sufficient detail, or is more detailed information needed? As a stakeholder, is there anything not included in this report that you would like to see? And any thoughts on excluding any information that's currently proposed?

So, I will stop there and again just

open it up for your feedback, your comments, your questions.

CHAIRMAN McWILLIAMS: I just want to make sure everybody has a copy of the report.

MEMBER WILLIAMS: Just a comment on it, I think it's good, I think there's a lot of good information in there. My only question though is the completeness of it, because the ombudsman is a resource that we can certainly go through, but the other resource is directly to the regional FDIC person -- if I have an issue, I call Kathy Moe, and we tend to talk about it. And periodically, that can be information that would be on the report, but isn't because we have that relationship where you can have a direct conversation. So, I don't know if it provides you the completeness of the data you're looking for, or even if that matters.

CHAIRMAN McWILLIAMS: Yeah, and Anthony knows this, we're looking at our ombudsman process. And exactly for that reason, some of the agencies have the informal dispute resolution, and some have informal and formal. So, we're looking at all of that, just to make sure we have a comprehensive picture of how we handle this, and that there's a real channel for banks to challenge whatever they want to challenge, and for us to be responsive to that.

MEMBER K. KELLY: I'd like to comment on that. A couple of things, one, let me commend you for the report. I think there is a need for it. It helps to communicate what the ombudsman role is and how it could work for our institutions. I would tell you, for maybe the CEOs around this table in general, we probably have the personality to have a high relationship with the FDIC at the right levels. But I see it from another perspective, which is, there are institutions that want to be able to ask and probe in the right way. And the ombudsman role, from my perspective, is duly noted and needed to do that.

And so, I can tell you, from having dealt with several institutions that -- in particular, say, minority institutions -- having an ombudsman allows us to really kind of probe in a way that feels a little bit safer than normal, versus having to get hit over the head, because once you have that direct conversation, the confidentiality and how it's dealt with is just completely different.

And so, my point Chairlady McWilliams, is that there is definitely a need for this role, and I am in full support of it. I would say, can we continue to build out what this report represents - will help communicate the role and responsibility in a way that could be more effective.

MR. LOWE: And that's definitely one of the purposes of this report. Because when I do have my regional folks going out on a weekly basis visiting individual banks, I'm surprised when they send their weekly reports in to me, where they say, this is the first visit that we've had, and the bank was not aware of the services and assistance that the ombudsman can provide. So, that's part of the awareness project that we've been focusing on for the last year and a half, and plan to continue doing into 2019, 2020. And that's part of why this report, I think, is important.

MEMBER MENON: Is there a process where there's feedback after you talk to the ombudsperson about some issue or something? I just wanted to ask that because we did this several years ago and never heard back from the ombudsperson. So, maybe things have changed over the years, I can talk to you about that in private. But you know, basically, it just died. We never got any feedback.

MR. LOWE: You know, generally, if a banker or a stakeholder brings an issue to us that they would like for us to do some kind of research on, if it's in regard to, you know, definitions of a rating, or, you know, what the general process is with an application, we'll have that discussion and try and make sure that we conclude that matter.

Sometimes, there will be some ongoing issues that the banker will inquire about. And we do try to do go back and close those issues out at some point in time. You know, sometimes there will be some open-ended items that we just can't get to a full conclusion. But you know, if it is an open item, we will make sure -- we try to make sure -- that the banker or the stakeholder knows we're continuing to review this matter. Or if we need some additional information, we'll let you know that also.

CHAIRMAN McWILLIAMS: Arvind, I'm curious in your feedback, so we can talk after this.

MEMBER MENON: Again, it goes back several years.

CHAIRMAN McWILLIAMS: Sure, sure, no, not a problem. And even if it's anecdotal, it's fine. Please understand, the role of the ombudsman is very important to us because it's a channel that needs to be utilized. So, Ken, if you have some suggestions on how we can improve it, or anybody else, please give us those suggestions, either by a formal letter -- comment letter -- or just send us an email. But we want to make this position -- Anthony's fully committed -- we want to make this position as robust as possible, and viable. So, part of the outreach is exactly that, how can we can we get to a place where banks are comfortable reaching out and expect some kind of a resolution and feedback. So, we need to come full circle on this.

MR. LOWE: And if I can just add one other comment, you know, the comments that we get, especially when we have meetings with bankers, that information is confidential. It's not going to be shared with any of the operating divisions, or anyone outside of the Ombudsman Office, with the exception of possibly the Chairman's Office, if we think there's an issue that needs to be addressed or brought to her attention. So, anyone that contacts our office should be very comfortable with sharing any information and a lot of candor with us, because, again, it is again maintained in a confidential manner.

MEMBER DONNELLY: Anthony?

MR. LOWE: Yes, sir?

MEMBER DONNELLY: Just one general comment on the report. You know, if you look at the topics and the different things -- and I know it's a fine line between not enough information and too much information, and protection of confidentiality. But, just a comment, examination issues is pretty broad. Is there any way to layer in general topics? Because somebody may see that, hey, that's exactly what's happened to me, when examination issues, to all of us around here, are -- you would have 15 or 20 different comments. What does that mean? And I know you can't go and write 25 pages per incident, but just a way to maybe define -- That would be a suggestion.

MR. LOWE: Okay, great.

MEMBER SCULLY: So, I think it's wonderful that this is being emphasized. I would say that there's probably still a lot of residual skepticism on the part of the industry, as to whether or not you can go to somebody within the FDIC and complain about the FDIC. So, there's just that natural skepticism that has to be overcome.

I think the best way to overcome it is to just reiterate the message over and over again that this is taken very seriously. And with that in mind, I'm not sure this is the vehicle to do it. If I think about limited resources and limited funds availability, that an annual report is going to have that kind of iterative effect of really making people less skeptical.

And I'd agree that some of the data that's here, in isolation, just as data, is going to raise a lot more questions than it's going to answer. I mean, you know, we're all bankers, so we look at these things -- you know, I look and see that the public is the primary source of contact. That really surprised me. And yet, the five topics of interest, one of the greatest ones is examination issues, which seems like a disconnect. Is the public going to the ombudsman about examination issues?

And, you know a total of 800 visits in two years, given the number of institutions insured, is that a message right now that we want to send, or do we want to get that number up before we advertise it.

I mean, so, I'm just not sure this is the vehicle. I think it's very important, but my initial recommendation would be, I don't think this is the vehicle to get that message across.

CHAIRMAN McWILLIAMS: That's fair. And this is one of the vehicles we want to use. And to the extent that we use it, we want to make it a viable vehicle. So, we're not just looking to check the box. And you have my personal commitment, I will highlight this in public presentations, and encourage banks to use the ombudsman process, and make sure people understand it's truly independent from the rest of the FDIC, and what people communicate to Anthony's office does not get elsewhere, and we take those things seriously.

So, I will personally take an initiative, and you have my commitment that I will go and advertise this as one of the main features for banks to challenge, what they feel that hasn't been done right, vis-a-vis our examinations, et cetera.

But if there are other ideas, I am very much so open to it.

MEMBER EDWARDS: You know, I think this is not easy, but I've been a banker for 25 years. And other than working, when we were purchasing assets of failed institutions, that's really the only time I've worked with the ombudsman. And about a year ago, Edie Fulcher in the Atlanta office called me and said, hey, I'd like to come down and see you. I just want you to know who I am, what we do, what we can do for you, and, you know, make sure you understand everything. And that was really helpful.

She probably took an hour and a half. We went through everything that the office does, and what they can do, what they can't do. So, you know, people deal with people. And so, I think having that kind of one-on-one relationship now would make me much more likely to reach out to her when questions arise and things.

I know there are a lot of banks in the country here, and that's an expensive way. But I think -- and I will say I know that the Office of the Ombudsman really is at a number of banking functions, through ABA, and ICBA, I'm sure, and other functions. I appreciate that, and that's a good way to meet folks, but that doesn't substitute for being able to sit one-on-one across the desk and have somebody in your shop do that. So, I know that's probably expensive, but I think that's very valuable time, and I appreciate the FDIC doing that.

MR. LOWE: And I appreciate that comment. And Mary, to your comment, you know, we do realize, getting to 400, 500 banks on an annual basis out of, you know, 3,600 or 4,000 that we directly supervise, it's going to take us, you know, six, seven, eight years before we get through the entire cycle.

So, one of the items that we discussed at our quarterly meetings and our annual meetings is, how can we get the outreach and the numbers up? Because I agree, the personal contacts are much more important.

One thing that I'm considering -- you know, we do have some senior ombudsman specialists that are here in Washington. I've been talking with them. Some of them have not been out to visit banks in several years, and they've indicated a willingness to do that.

So, we are going to try to augment, you know, the outreach, the actual outreach. Because we do get much better, I think, information when we do go on site and have those on-site visits.

One other note, you know, in regard to those contacts that do come in from the public. Some of those are -- they're categorized as from the public, but they do come sometimes from whistleblowers that actually work at banks and maybe have an issue that has come up that they have some concerns about, and they just want to report it to us and say, hey, this may not be kosher, this may not be legal, something.

You know, your folks may want to look at during the course of the next examination. So, a large number of those contacts that we get from the general public are those whistleblowers. And they do of course want to -- it has to be a confidential type of a contact.

MEMBER TOLOMER: I think I would echo one thought, and that is, we've all probably worked very hard with our local offices to have a strong relationship, and we've been able to resolve things. But in the off chance we're not able to resolve things, I think it's comforting to know there's another place to go to have a hearing, beyond just butting heads.

Now, we haven't had any issues, fortunately for us, in the 10-year existence. But it's good to know that if there was an issue, there's a place to go.

MEMBER HANRAHAN: So, Madam Chairman, along the lines of what John just said, I think it's a great idea to promote and educate on the Ombudsman's Office. As you're promoting it, I would respectfully suggest that the message be delivered in a way that bankers don't think that that should be their first recourse.

Because whenever I've had to go to the New York Region, R.D. Vogel and his team are great at being responsive and accessible, and I've never had to go to the Ombudsman's Office because we've resolved things there.

So, I would hope that the message couldn't be interpreted by bankers that that should be their first place to go, because that would seem to me to be a poor use of resources.

CHAIRMAN McWILLIAMS: Okay, I will definitely -- and you'll see some stuff coming out from the FDIC on the role of the ombudsman, and I think you'll be pleased with an ability to provide a comment letter perhaps.

MR. LOWE: David, you know, when our regional folks go out, or when I go out and visit, and if a banker does bring a matter forward, one of the first questions I ask is, did you talk with the EIC, with the local management, with the regional folks? Because, I agree with you, that's usually one of the best methods for getting something resolved in a timely manner, so I always ask that question and my staff does too.

MEMBER HARTINGS: Anthony, just a follow up on several of the comments that were made, they were all great. I mean, I think the report is good. I think you have to think about your audience. I mean, I guess I think this report is good if I'm your boss. It may not be quite as good if I'm a community banker, because I want to know the community bankers' aspects. So, I want to just cut that out there.

And I've learned from regulators, report it and then I can hold you accountable, so I do appreciate you doing a report too, as far as that goes.

MR. LOWE: Maybe I should rethink this.

(Laughter.)

CHAIRMAN McWILLIAMS: I'm getting all kinds of ideas.

MEMBER HARTINGS: But I think you have to start somewhere and then see where it grows. Because if you want community bankers to be your audience, it needs to be a different report.

And again, because you're -- you've got a lot of moving parts here. But again, I think start it, do the best you can. It's accurate, there's no doubt about it. But I want to know the specifics. When you say examination issues, that doesn't mean a lot to me because there's a wide -- and there's a lot of issues. But again, that's because I'm reading it as a community banker, and I really want those issues only brought up with other bankers mostly, because it gets me an idea -- you know, it just, and again, I may want the public one as well, but again, that's slicing and dicing it a little bit at that point.

MR. LOWE: Let me ask you, because one thing, when I was talking to my staff earlier this week, we were thinking about maybe building in some information that would differentiate among the asset size. You know, maybe up to 250, and maybe having a couple of charts that show what issues came up from different segments of asset sizes. Would that help in that regard a little bit maybe?

MEMBER HARTINGS: I think that would be

good. I'd go back to what I think Chris said. You know, the problem is, it's not an objective view. It's a very subjective view. It's the ones that called you that you've viewed. Unless your ombudsman is going to look at a wider number of examinations, even those that, you know, again -- so, it's going to be limited value because, again, it's just the ones that called you. And I mentioned saying James Meyer in Columbus. He's the one I call first. You know, so. I'm not sure.

Like I said, I think you have to just do the report for a while and say where's the value? I think you've got to watch your resources. Mary Ann was exactly right. You've got to be careful what you're trying to get out of this because, number one, we want to make sure you're a line of defense for bankers, that they know they can call you without retribution, but don't call you first. You know, all those kind of things is number one.

Reporting is important, but let's see what we get out of the reporting. So, I mean, like I said, once you start reporting, you have to kind of think of your audience and other things. That's my only comment. I think all the other comments have been great.

MEMBER EMMONS: And let me just put another perspective on this. In addition to knowing what it is and maybe going into more depth. I think it would be very helpful for you to be able to share in a very confidential way successful outcomes. So, examples of conversations that have taken place, where you have felt that you've provided a valuable service to the organization, and they would agree, that, you know, this was -- this process worked, it felt transparent, I feel good about the outcome. Those kinds of things I think would give us a better sense, not just what the topic was, but how the office assisted the bank in dealing with the issue.

MR. LOWE: Any other comments?

Well, we did have, hopefully at each of your locations, contact information and my personal business card. So, if you do have some additional thoughts, email me, call me. I'll be here all day. Catch me at lunch or one of the breaks. I definitely want to get some additional input from you. So, thank y'all for your time.

CHAIRMAN McWILLIAMS: And thank you all. This was a great discussion. I appreciate it.

MR. DAVIS: And next up is lunch. We'll be back here at 1:00.

(Whereupon, the above-entitled matter went off the record at 12:00 p.m. and resumed at 1:04 p.m.)

MR. DAVIS: Okay, if we could please have a seat, we will get started with the next panel. Okay, welcome back, everyone. I would start the afternoon portion of the meeting by discussing industry collaboration issues. We have Lisa Arquette from the Division of Risk Management Supervision; Lisa is an Associate Director who oversees our anti-money laundering group. Betty Rudolph, the National Director for Minority and Community Development Banking. And Jim Watkins, Senior Deputy Director of Supervisory

Examinations in the Division of Risk Management Supervision.

Lisa is going to start by highlighting the Shared Resource Statement regarding the Bank Secrecy Act. Betty is going to discuss collaboration with minority depository institutions, and Jim is going to cover collaboration with de novo institutions.

Thank you. Lisa?

MS. ARQUETTE: Thank you, Chad. And good afternoon, everybody. It's a real pleasure to be here. The slide deck that you have in your materials is what I'm going to go over; it says sharing resources to manage Bank Secrecy Act obligations. And if you were following the press releases on October 3rd we issued through a press release some guidance, a statement for the industry in considering initiatives to deal with efficiency and effectiveness. The FDIC along with the other federal banking agencies - the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the National Credit

Union - and the Financial Crimes Enforcement Network, FinCEN, we have issued a statement regarding sharing of BSA resources. But before that I would like to note just overall, there is a bigger initiative underway, and that is to deal with efficiency and effectiveness in the Bank Secrecy Act anti-money laundering area; I'll refer to it as BSA/AML regulations going forward. We're also evaluating supervision in this space, enforcement, and really is there anything that we can do in terms of our examination process while meeting the requirements of the statutes and regulations, continuing to fully support law enforcement, recognizing innovation in AML techniques and reducing the burden of BSA/AML compliance. Again, our partners are the other banking agencies as well as FinCEN.

Moving along to Slide 2, on October 3rd we issued our press release and it deals with the burden of BSA/AML obligations that have been raised many times by the industry as well as other parties. The cost of meeting BSA requirements and effectively managing the risk that illicit finance poses to the broader U.S. financial system may be reduced through sharing employees or other resources and collaborative arrangements with one or more financial institutions. Collaborative arrangements involve two or more banks with the objective of participating in a common activity or pooling resources to achieve a common goal. The statement describes how collaborative arrangements can be used to pool human, technological and other resources to reduce costs, increase operational efficiency, and leverage specialized expertise.

Moving onto Slide 3; the collaborative arrangements described in this interagency statement are most suitable for banks with a community focus, less complex operations and lower risk profiles for money laundering and terrorist financing. I should also point out, although it may not pertain to anybody here, that this statement does not apply to collaborative arrangements or consortia that are formed for the purpose of sharing information under Section 314(a) of the USA PATRIOT Act which is known as the voluntary information sharing, Section B, it's between banks. So there are many banks that have voluntary consortia to share information. It's a little more simple than that; as a reminder, banks are required to establish and maintain procedures reasonably designed to ensure compliance with the Bank Secrecy Act and to develop and implement BSA/AML compliance programs; those programs should be commensurate with the bank's specific risk profile. The risk profile of a bank should be based on the institution's risk assessment that properly considers all risk areas such as products, services, customers, entities, transactions and geographic locations in which the bank operates and provides services. The BSA compliance program is illustrated on Slide 4 and includes a system of internal controls to ensure ongoing compliance with the Bank Secrecy Act, independent testing of the BSA/AML compliance program, a designated individual or individuals responsible for managing BSA compliance, training for appropriate personnel, board members all the way down to staff-level personnel, an established customer identification program, procedures for customer due diligence, which became effective in May of this year. Collaborative arrangements may provide access to specialized expertise to assist banks in meeting the BSA/AML compliance program requirements that may otherwise be challenging to accomplish without such collaboration.

Slide 5. I would like to provide a couple of examples to describe situations in which collaborative arrangements may be beneficial for banks. In terms of internal controls, the internal control requirement, a collaborative arrangement might be entered into by two or more banks to share resources between the respective institutions to conduct certain internal control functions such as reviewing, updating and drafting BSA/AML policies and procedures, reviewing and developing risk-based customer identification and account monitoring processes, tailoring and monitoring systems and reports for the risks posed by each institution. In terms of the independent testing requirement, banks are also required to provide for independent testing to determine that the bank is in compliance with the Bank Secrecy Act; that can done either internally or it can be done with an outside party. Such testing should provide an evaluation of the adequacy and the effectiveness of the bank's BSA/AML compliance program. Some banks may have personnel that perform multiple job functions making it difficult to identify an employee within the bank to conduct an independent test of the Bank Secrecy Act/AML compliance program. Personnel at one bank might conduct the BSA/AML independent test at another bank with a collaborative arrangement between the two; the shared resource may, for example, be utilized in scoping, planning, and the performance of BSA/AML independent testing. With that said, appropriate safeguards should be in place to ensure confidentiality of sensitive business information. The banks should be involved in the collaborative arrangement, the banks that are involved in the collaborative arrangement also need to ensure that the shared resource conducting the BSA/AML independent testing is qualified and not only with the BSA/AML functions, but in the materials that are being reviewed, such as training and developing policies and procedures. We want to ensure that this does not present a conflict, so the employees should be trained and should be independent. In terms of the training requirement, banks are required to ensure that the appropriate personnel are trained in BSA regulatory requirements and in internal BSA/AML policies, procedures and processes. It may be challenging to acquire personnel with BSA/AML expertise in some communities; it may also be cost prohibitive to attract a qualified, off-site BSA/AML trainer; however, in a collaborative arrangement between two or more banks, there is latitude in hiring a qualified instructor to conduct the BSA/AML training, allowing the banks to share the costs. Examples of basic BSA/AML training topics may include alerting - the alert analysis in investigative techniques, alert trends in money laundering methods, as well as regulatory updates.

Other considerations; when considering a collaborative arrangement for a BSA officer, we think that there might be many challenges that community banks might face. The sharing of a BSA officer among banks could be challenging due to the confidential nature of suspicious activity reports filed and the ability of the BSA officer to effectively coordinate and monitor each bank's day-to-day BSA/AML compliance. In addition, the sharing of a BSA officer may create challenges with effective communication between the BSA officer and each bank's Board of Directors and senior management. Accordingly, it may not be appropriate for banks to enter into collaborative arrangements to share a BSA officer; in certain circumstances it may be appropriate to share an officer but we do think that you should raise the issue with your regulator, the FDIC, before doing that.

I would like to move onto Slide 9, Risk Considerations and Mitigation; the use of collaborative arrangements to manage BSA/AML obligations requires careful consideration, collaborative arrangements should be consistent with sound principles of corporate governance. A bank's Board of Directors should provide for appropriate oversight of BSA/AML collaborative arrangements in advance of entering into these arrangements. Reasonable systems should be established to ensure that bank management adequately oversees the activities of the shared resources, banks should devote sufficient resources for monitoring the services performed under the collaborative arrangement. Another standard practice is to support the collaborative arrangement with the contractual agreement between the parties. A collaborative arrangement for sharing employees or other resources to manage BSA/AML obligation is similar to using dual employees. Periodic reports related to BSA/AML collaborative arrangements should be provided to senior management and reported to the Board of Directors as appropriate in conjunction with regular oversight of bank activities. Banks must also comply with all applicable legal restrictions, including limitations on the disclosure of confidential supervisory information, confidential and business information, individual customer data, and trade secrets, as well as restrictions governing collaborative arrangements among competitors. A collaborative arrangement should be appropriately documented to define the nature and type of resources to be shared, define each institution's rights and responsibilities, establish procedures for protecting customer data and confidential information, and develop a framework to manage risks associated with sharing resources.

That concludes my comments. I'd be happy to either take questions now or at the end of the presentation.

MEMBER K. KELLY: Lisa, is there data that suggests a range of anticipated savings for looking at this level of collaboration? I think many of us probably have an idea of what it costs us, but is there any research on that?

MS. ARQUETTE: We don't currently have research. I mean, we know that some banks are already engaging in collaborative arrangements whether by contract or otherwise. We know that banks share resources for training purposes, independent testing – it's similar to a third party, commitment with an outside party, but we do not have the data right now on what the cost savings would be.

MEMBER K. KELLY: I understand.

MS. ARQUETTE: Thank you.

MEMBER K. KELLY: Thanks, Lisa.

MEMBER PAINE: We actually have been doing this for over six years, and it's not just BSA; we have some banks that are $25 million and they just don't have the expertise in-house, or the ability to have independent testing of much. So we actually have been helping them with internal audits, like I said, for over six years, and ultimately we put together an engagement letter and we do it at a discounted rate basically to cover the training of our employees and allow for redundancy on our end. It's worked out well; it's been a good benefit for both.

MS. ARQUETTE: Yes, we think that it's a good practice and we wanted to really highlight the benefits of doing that.

MEMBER PAINE: We work with six other banks -- seven other banks, I'm sorry.

MS. ARQUETTE: That's good to know.

MEMBER DONNELLY: Just a question for -- how do you see bank or state bank associations being involved? We use a state bank association to do some audits and some back testing, but this is more forward-looking than looking from your rear view mirror. So have you thought how that would come into play as to contractually for the front end or -- I hope I'm making sense, because when I read this I was intrigued by it when it came out because it is a large cost for us.

MS. ARQUETTE: Absolutely. Well, I guess it would be like any third party, right; somebody not in the bank conducting different types of BSA compliance obligations, regardless of the third party, just knowing what the responsibilities are of each party, monitoring to make sure that what you've contracted for, what you're paying for is what you're getting. So I would view that as any third-party relationship, if that makes sense.

MEMBER DONNELLY: Mm-hmm.

MEMBER SHETTLESWORTH: This seems like a proactive solution that I'd not been aware of and not even thought about, and I can assure you we'll bring it up at our state association meetings in the following years. So this is fascinating to me, but I hope it doesn't just necessarily stop here from the FDIC's standpoint because over the number of years, over the last three to four years this concept has been brought about concerning mortgages, residential mortgage loans having some type of shared originator and compliance function within the state that state member banks can participate in. And so, this is proactive, I'm very curious about it, but hopefully this kind of proactive thinking continues because this is fascinating.

MS. ARQUETTE: Well, you'll see more in the BSA/AML space, but I can't speak to anything beyond that.

MEMBER SHETTLESWORTH: Okay.

MR. WATKINS: I do think it's probably fair to suggest, though, it could have implications more broadly for other operations of the bank and we would encourage that as well.

MS. RUDOLPH: Excuse me. Okay, good. So as Chad mentioned, my name is Betty Rudolph and I am responsible for mission-oriented banks, minority banks and community development banks. And that's a portfolio of approximately 155 banks across the country; half of them serve Asian communities, about 25 percent Hispanic, about 15 percent African American, and 12 percent Native

American banks. And this program is supporting five statutory goals that we have to preserve and promote minority institutions and an FDIC policy statement in that regard as well. And so the initiative I'm going to talk about today is a collaborative initiative similar to what Lisa talked about for minority banks to collaborate either with other minority banks or with non-minority banks in a variety of areas. And to support this initiative we published a resource guide late last December and we've been sort of promoting that this year, and so I'm going to go through that, and it's also in your packet called Resource Guide for Collaboration with Minority Depository Institutions.

So one of the impetuses behind it is that both MDI, minority depository institutions, and non-minority banks can receive regulatory and business benefits from collaboration and partnering, and that MDIs are often more familiar with the economic development needs in their communities, and non-MDIs can benefit from sound and profitable lending and other relationships, and investments in under-served communities. And so the remaining slides I'm going to go through what some of those collaborative opportunities might look like. So on Page 3 just the four collaborative arrangements could include direct investment in an MDI, loan participations or other lending arrangements, sharing of bank staff and other resources similar to what Lisa talked about, and information networking. So I'll describe each of those a little bit more in detail. So direct investments would include placing deposits in an MDI, making a direct capital investment or participating in a fund that makes direct investments in an MDI.

On Page 5 with respect to loan participations; some of the benefits of that are expanding MDI capacity so they are able to engage in larger loan transactions. So we have examples of a very large bank in Texas, a $25 billion bank that's doing loan participations with an MDI sort of at a $2 million, $1 million level rather than the $10 to $15 million level which that bank normally engages in. The collaboration through loan participations also provide access to special resources or unique skill sets that the collaborating institution may have that the MDI may not have. And they create opportunities on both sides of the partnership to diversify loan portfolios, enhance liquidity and interest rate risk management and serve the credit needs of a wider range of customers.

So in terms of the loan participations, partnerships could take the form of lending consortia, community development financial institution, CDFI, community development entities, loan funds or special purpose entities that might be created, limited liability corporations to manage troubled loans or other real estate owned. And we have some examples of where MDIs have collaborated in this space as well, some of them using new markets, tax credits to engage in much larger projects that the MDI might not have been able to engage in on their own.

Turning to sharing bank staff or other resources; examples include providing access to specialized skill sets through bank staff or consultants; these could include human resources. We have a number of institutions that have lent talent management services to MDIs, internal audit, asset valuation, or managing problem assets, expertise in niche lending - for example SBA lending, as well as waiving ATM fees for MDI customers. Citibank has made available their ATMs, about 2,400 nationwide for a group of about 27 minority banks and low income credit unions to use without out-of-area fees.

In terms of information networking, trade organizations that focus on underbanked or unbanked consumers provide training information on the availability of MDI investment opportunities. And the FDIC also provides a number of networking opportunities, including regional roundtables for MDIs once a year and an interagency conference every couple of years for opportunities to network.

MEMBER TURNER: Is that opportunity

for them to network among themselves or with potential people to partner with as well?

MS. RUDOLPH: Yes, we have had instances where we've brought together MDI trade groups with CEOs of non-MDI institutions to explore those opportunities. The last one we did was in Salt Lake City with a number of the ILCs and they kind of made their pitch for the ILCs for what their needs might be in that case; they were looking for Community Reinvestment Act consideration. There weren't as many opportunities in Salt Lake and so we brought MDI trade groups to share what they were looking for as well.

MEMBER TURNER: I think those will be helpful to involve a broader audience, so maybe some networking could be done and relationships established.

MS. RUDOLPH: That's a great idea, yes. The other -- and I was going to get to this at the end but we can talk about it now -- a number of state associations as well, MDIs have brought forward this actual resource guide as we've been promoting it to other state associations and looking for potential partners and had some receptivity to that as well. So there are a number of different channels for doing that.

So turning to Slide 9 on community bank benefits; enables partners to serve bank customers that neither institution could serve alone, has the potential to reduce operating and compliance costs by sharing back office operations and specialized expertise, and jointly developing products and services at reduced costs.

So turning now to Slide 10 which is opportunities for CRA consideration. So all banks, including everyone sitting at this table, receive consideration under the CRA for activities in their assessment areas and the broader state-wide or regional area if it's responsive to the community development needs in their assessment area. And non-MDIs can also receive consideration if they partner with a minority institution outside of their geographic area. So when we had that roundtable in Salt Lake City, for example, those institutions were looking with partnering with MDIs across the country and had the potential to earn CRA consideration for those partnerships.

MEMBER TURNER: So the CRA credit you earn, you don't have to partner with a MDI located in one of your --

MS. RUDOLPH: Assessment areas, that's correct.

MEMBER TURNER: Assessment areas.

MS. RUDOLPH: And the consideration is that it benefits that MDI in a location where they're chartered. So some examples of that making a deposit or capital investment like we talked about, purchasing or selling a participation in an MDI's market areas, so, Joe, some of those examples included MDIs looking for earning assets from a bank outside of its local area. So those would qualify as well. Loaning an officer or providing other technical expertise, providing free or discounted data processing systems, and contributing -- the value of the contribution or the loss incurred by donating, selling below market rate or renting for free a branch that's located in a minority neighborhood. And that has occurred as well.

So just turning to the last slide, Slide 12, just some points on finding MDI partners; FDIC has regional MDI coordinators in each of our six regional offices. We also have community affairs regional managers that are familiar with their area, state or regional trade associations, community development or CRA associations in the states are a good place also to look for collaborative opportunities, and then MDI trade associations.

MR. WATKINS: I'd like to also just follow up a little bit; this suggests that each of our regions has CRA specialists and they would be available too to help ensure that you're getting attention or the investment interests that you would want in such an investment. So reach out to them as well.

MEMBER TURNER: So if we're interested

in some of these opportunities or at least finding out about them, that's who you would suggest we call first?

MR. WATKINS: I think you have two choices; you can work through our MDI coordinators in concert with a CRA specialist who really are the experts in CRA matters.

MS. RUDOLPH: And we maintain a list of these minority banks on our website, so it's fdic.gov/mdi and there's a whole website there. And I'm also available here in Washington if you have some questions about that as well.

MEMBER K. KELLY: I'd also like to offer, I'm serving as a new chairman of the Minority Banking Association and would be happy to speak with any of my colleagues here in looking at potential loan participations, et cetera that could help strengthen those institutions while you're also getting CRA credit. We'd love to make ourselves available for that.

MS. RUDOLPH: Thanks, Ken.

CHAIRMAN McWILLIAMS: And we're also

looking to increase the participation of MDI members on this committee as well, so you'll have a broader audience for the engagement and pursue some of these ideas as well.

MR. WATKINS: So next I'd like to discuss a little bit on the efforts the FDIC is taking for de novo bank formation; so that's new banks, if you will; we call them de novo institutions. And to promote and encourage the formation of de novo banks; in 2016 and in 2017 FDIC staff participated in day-long sessions at each of our regional offices, meeting with potential new organizers for de novo institutions and other parties that have interests in forming de novo institutions. And so we had our day-long agenda where the regulators, we had both state regulators, the Office of the Comptroller of the Currency for national banks, the Federal Reserve was there, of course FDIC officials were there. We walked through the application process, we talked about the statutory factors, we described business plans and how to develop business plans and what's expected there. And there was another session on Community Reinvestment Act and how to complete that part of the application, if you will. But without a doubt, the highlight of the day, and we get this from the feedback after the session, was a session that bankers participated in, so there was a panel. So this wasn't the regulators; this was a panel of bankers that described their experiences and kind of lessons learned in forming de novo banks, and some of the lessons that came out of that was the level of cooperation and collaboration that bankers achieved. And in fact, some members here I know today participated on those panels, and I hope you speak up. For example, every bank will need a loan policy, right? So every bank will need a loan policy and organizers found a lot of success in just reaching out to other bankers, existing banks, that provided them copies or drafts of loan policies. And they can use it as kind of an outline, at least, in developing their own policies. And there was a lot of policies that bank regulators happened to like; loan policies would be one; there's also an interest rate risk policy, funds management policy, and CRA policy. So this level of interest in collaboration, I think, was informative to those interested in organizing a bank that they could actually reach out to other existing bankers, and they were very helpful in providing suggestions and useful tools in consideration of formation of a business plan, for example.

Another issue that any time you form a new business, it's a very difficult, delicate period and it takes a while to achieve profitability. And so there was some success achieved through loan participation. So this is where one bank will help provide initial credit, if you will; you can buy a loan participation, so you're building up a relationship, and also existing banks will readily provide, in many cases, correspondent banking relationships. So if you can't serve all of a particular customer's needs, maybe through the relationship you can establish from a correspondent bank, it can provide those services until this new bank is able to build up its staff and expertise and systems in place.

Another lesson I think that came out of this quite strongly was information technology, so that's a huge challenge for all of us, and is particularly a challenge when you're forming a new company or a new bank in particular. And some of the lessons that came out of this kind of around this collaboration and cooperation was the fact that you can share experiences in developing your contracts, and probably the best time to negotiate the things you want in that contract is when you first sign an original, initial contract for services. So it was a remarkable amount -- in my sense anyway -- there was a remarkable amount of interest by other banks, existing banks in supporting the formation of new banks, and it’s an extraordinary resource that can be made available for de novo institutions. So that was a big lesson that came out from our day-long sessions around the country; clearly the feedback forums was much better than what the regulators provided, if you can believe that. And I think the organizers that were considering forming new institutions really gained a lot of insight from that, and we are starting to see revised interest in forming new banks, and so we're very much encouraging that. And anything you could do to help support that we would appreciate. So I'm hoping, John, maybe you can add to that if you had any other comments in regards to your sessions and the collaboration that you thought might be useful, for example.

MEMBER HANRAHAN: You summarized it very well, Jim. I think one of the biggest takeaways for me from that outreach effort was there had been, and to some degree still exists a perception that the regulators have constantly ratcheted up the capital levels required for a new bank, and not only ratcheted them up but made a mysterious black box that organizers just weren't told how much capital had to be raised. And if I recall correctly, it was Doreen who explained at the New York meeting that I attended is that, look, we don't have a minimum capital level, other than you've got to maintain a 8 percent leverage ratio for your first three years, on your first capital raise, and show you can turn a profit inside those three years. You tell us how much capital you need to fulfill that business plan. I thought it was logical and elegant the way it was stated, and from the de novo approvals that I've seen so far, I've seen a varied range of capital levels approved depending upon what that business plan was. And I commend the FDIC for taking that approach too.

MR. WATKINS: That's the first time I've ever heard eloquent in relation to capital.

(Laughter.)

CHAIRMAN McWILLIAMS: No, they told us to describe somebody else.

(Laughter.)

MR. WATKINS: Fair enough.

MEMBER TOLOMER: I think, Jim, just to get to your point and I think David's, we were in the New York session together, and I think one of the things we were able to do is to try to explain to potential board members, to potential CEOs what some of the challenges are to actually starting; it's great to build a business plan, it's great to say that you’re going to have 8 percent capital in the next three years and be profitable, but how do you get to it, and how do you utilize, we talked a lot about technology and utilizing technology to reduce the number of people, but be able to increase the size of your business and customer base. So I think there was a good exchange for people to understand -- and David is right; they were very anxious, they wanted to put up as little capital as possible, but the reality is it's all about the business plan and trying to understand what is it you're trying to do with this bank that you're starting, what is your niche, who's your customer and how do you go about being successful. So I think we were trying to help focus where they were going to go with their business and with their bank and recognizing it's all well and good to have capital but can you turn a profit. And if so, how do you continue to build. So I think the feedback

I received in the two sessions I went to was that they found it very helpful to hear someone whose gone through the process and lived with it, and the other thing I think we made pretty clear was that we didn't view the regulators as the enemy; we viewed the regulators as partners, and we viewed the fact that being able to tell the regulators what we were doing as we were doing it I think was very beneficial certainly for our bank when we did it, and I think although what we started in 2008 and the first time I called to have a joint meeting, a lot of people showed up thinking that we were throwing keys back in 2009.

But the reality was I think that started a strong relationship in working and encouraging new banks to be able to -- they have nothing to hide, be open and honest and forthright, and in the end that would help them. So that was kind of the message that I think we were bringing forward. And the feedback that I got from the potential investors was very positive.

MEMBER HANRAHAN: Related to our

ombudsman conversation earlier, one of the comments I made on that panel was the importance of maintaining open face-to-face communication with your original office, and it's funny you're making this presentation because the anecdote that I gave was, oh, yeah. I'm telling it.

(Laughter.)

MR. WATKINS: So we can move on, Chad, at any time.

MEMBER HANRAHAN: Early on in our history I inadvertently violated our business plan that had been approved. And so I decided not to try and resolve it over the phone or via letters, but I went hat in hand to the regional director of the New York office who at the time was Jim Watkins and sat with him and his staff and we worked it out. And I didn't get everything I wanted, he probably didn't get everything he wanted, but we reached a middle ground that worked for us and got it through an issue related to brokered deposits.

CHAIRMAN McWILLIAMS: But David, was he eloquent?

(Laughter.)

MR. WATKINS: We don't have to worry about that.

MEMBER DONNELLY: Well, this is important to me and I appreciate the comments -- it's good stuff -- the devil's always in the detail. So as you start to work through that, where do you find that detail? There's a lot of little pieces that need to be input. And is there a place -- so it's not continually back and come back and come back and come back with more and more information that -- what would your recommendation be?

MR. WATKINS: So we very much encourage banks to work with other banks. In the formation of a de novo institution, really the business plan is extraordinarily important, and the concept of the business plan. Where banks have run afoul, if you will, is when they deviated sharply from the original business plan. Usually the business plan is a pretty good road map of a path to successful operations for a financial institution. And you can have deviations from the business plan as long as they're well-informed and thought through, and structured in such a way that it will lead to sustained profitability. So if an institution needs to change its business plan or add new products or something of that nature, it's good to get that discussed early on -- not after the fact -- early on with your friendly regulator to ensure that everyone's on the same page and the expectations are pretty clear. So I think that's an important environment. And frankly where we've seen banks run into trouble is when they substantially deviate and they grow rapidly, far more rapidly than they had originally anticipated. And without the control systems in place early on, it can end up leading to kind of excess risk and that sort of thing. So I think that is an important initiative and I think when banks enter into relationships with other parties, the third-party guidance is valuable and should be considered as you're forming those relationships, and consider all of those factors.

MEMBER MENON: So when we were a de novo

back in '08 any variations we were looking for from the plan had to be approved by Washington. Is that still the case or has that been delegated back to the regional offices?

MR. WATKINS: So almost all deviations from a plan, first of all, it has to be substantial like 25 percent or something of that nature, a substantial deviation from a plan, before it would require regulatory prior approval, and I believe the regions can pretty much do that on their own now at this point.

MR. DAVIS: Any other additional questions? I see our next presenters are here, so we're a little ahead of schedule, but we'll move to the next panel.

Thank you very much to this panel.

CHAIRMAN McWILLIAMS: This may be the only thing ahead of schedule in D.C., so enjoy.

(Laughter.)

MR. DAVIS: Our next session is something that came up at our July meeting and we committed to provide a briefing on assessment pricing for small institutions. From the FDIC's Division of Insurance and Research we have Diane Ellis, the Director and Patrick Mitchell, Deputy Director of Risk Analysis and Pricing.

MS. ELLIS: Okay, thanks. Happy to be here to talk about deposit insurance pricing. Pat will -- we've got a few slides in your folder, not many -- and Pat will walk through those which is designed to give you some context for overall assessment rates, overall assessment burden and so forth, and then also some of the particulars of the small bank deposit insurance pricing system, which just by way of background, has been in place for a couple years now, and it replaced a system that looked and felt sort of like the current system. But the underlying methodology was different, the underlying methodology of the old system was put in place in early 2000's and was essentially a CAMELS downgrade, a prediction of a CAMELS downgrade. And that's what drove the factors that were chosen and the weight given. With 500 plus failures of the most recent banking crisis it presented sort of an opportunity to see if we couldn't do a better job of having a better model to better differentiate risk. So the underlying model that drives the small bank pricing system now is a failure prediction model and it uses data going all the way back to the mid-1980's, so it's a very long period of time, many, many failures, and that's essentially what drives the ratios that are chosen and the weights placed on those different ratios.

So with that as background, now I'll let Pat walk you through some of these slides. And there should be plenty of time for questions afterwards. Please don't hesitate to stop us along the way if you'd like.

MR. MITCHELL: Thanks, Diane. So sure, any time questions along the way, happy to answer them; if you want to stop me along the way, feel free. I know you typically do.

So I'm going to walk through the slides and I'll start with the average assessment rate over time. And so this slide starts in second quarter of 2011, and the reason why it started there was that was when the assessment base was changed, and so the rates wouldn't have been comparable if we would have gone further back. So this shows the average assessment rate over time has declined from 11.8 basis points -- this is in basis points -- down to the current 3.7 basis points. So that's been a combination of a couple things; one is obviously, it's been a significant improvement in the financial performance across the industry, but also you can see here one contributing factor was almost a two basis points decline across the industry when the rate schedule changed when we hit 1.15, so that was when the rate schedule changed from 5 to 35 basis points to 3 to 30 basis points.

So this is really, I mean, quite a remarkable story and quite a strong story to show the decline over time. So now --

MEMBER TURNER: And that's against insured deposits is that right? Or assets?

MR. MITCHELL: So this is actual the assessment rate that gets applied against your assessment base, which is effectively your liabilities.

MEMBER TURNER: Okay.

MR. MITCHELL: So the next one I'm going to put it in context of income, which I think is probably the most relevant. The next slide shows the -- it's the same, similar slide; it shows the effective assessments on bank income, and this is again, using that same time frame, and this shows, again, the burden if you will has gone from 7-1/2 percent down to 2.1 percent of pre-tax income that we actually add back assessments because otherwise it gets a little odd, but I think the key point here is that this is, again, a multi-factor process; one is incomes, income has increased across the industry, so that's actually contributed to this. But also, of course, on the preceding slide you saw the lower assessment rates overall. So again, a strong story and with a significant decline here from 2016 -- this is 2017 -- I would anticipate this to really flatten; as you saw the 3.7 basis points on average, it appears to be it's still declining a little bit, but we expect it to flatten more as opposed to continuous declining, absent of course, increased income growth on this page.

So on the next page we put assessments, and this shows the percentage of small bank assessments as a percentage of total assessments, and so what this is really intending to show are a few inflection points here; in particular the change in the assessment base that I mentioned, so that was a result of Dodd-Frank, and so Dodd-Frank required us to effectively go to total liabilities. It's total assets minus tangible equity, but in short term we'll call that liabilities. And the intention of that was really to have assessments be closer related to the overall assets -- I mean, that was the intention of the Congress, and so you can see that change from 30 percent of assessments in small banks down to 20 percent, which was roughly in line with the amount of assets in the industry. So that was a big shift from small banks to large banks in terms of the overall assessment burden.

You can see it really kind of, I'll call it treaded water along the 20 percent over time until the decline in the rate schedule, and this declined down from 20 percent to approximately we'll call it 11-12 percent, and now down to 10 percent was a result -- that's including the large bank surcharge that's been placed on them to grow the fund from 1.15 percent to 1.35 percent. So there's a surcharge on the large banks of 4-1/2 basis points and that reflects that. Now, what we expect when we hit 1.35 which we expect to hit later this year, we possibly could have already hit it today, we just don't know it -- we need to see the reported amount of insured deposits and so on and so forth -- so we'll report those with the quarterly banking profile. But we expect that 10 percent to increase back up and around the 20 percent level again.

MEMBER K. KELLY: Can you explain that, why is that again?

MR. MITCHELL: So right now there's large bank surcharges that are in place to grow the fund from 1.15 to 1.35 percent, so that was again part of the required by Dodd-Frank with the increase for our minimum reserve ratio from 1.15 to 1.35. Once we hit 1.35 the surcharges will terminate. And so now you won't pay any -- the small banks won't be paying any larger, but as a percentage that will be gone and so now it will be closer to the assessment base. Does that make sense?

MEMBER K. KELLY: It does.

MR. MITCHELL: Okay. The next page shows the distribution of assessment rates, and this is for all small banks, for those $10 billion or less. And so the rate schedule is currently 3 to 30 basis points, so that's the minimum assessment rate without what we call the below the line deductions, so if you issue unsecured debt you can go below 3 basis points. But what you can see here is over 60 percent of small banks pay 3 basis points or lower, so over a majority pay 3 basis points or lower and then the distribution is spread out as you can see.

I don't know where each of you all fit in this but you might find yourself here.

The next page goes into the factors used in small bank pricing, so they're actually pretty straightforward; you have CAMELS ratings and I'm not showing the weightings here because they're really not super intuitive. I'm going to talk on the next page about what the largest drivers are in the pricing, but if you just look at the weightings per se, it's a coefficient; they're not really intuitive; but weighted-average CAMELS, leverage ratios, capital measure, the net income before taxes, again an income measure, non-performing loans and other real estate owned, those are both asset quality measures. The brokered deposit ratio, again, that's only for brokered that are greater than 10 percent, and again reciprocals are currently excluded for being well-rated – well-rated and well-capitalized institutions. And then the Loan Mix Index and the one-year asset growth; I think the point of this, these are all statistically derived, and so they are all used, as

Diane had mentioned, as a predictor using the statistical model to come up with the predictability of failure than the non-funding ratios. They were all statistically significant and the weightings were derived and such.

So the next page shows the greatest factors in terms of what's driving pricing in small bank pricing. So the first is the leverage ratio -- this is on average, so I want to talk about this on average -- then we'll talk about how varied it can be depending on your institution -- the leverage ratio is the greatest contributor -- the Loan Mix Index is the second largest, and the third is weighted average CAMELS -- and these three are on average by far the largest contributors to determining the price of deposit insurance.

MEMBER SHETTLESWORTH: Patrick?

MR. MITCHELL: Sure.

MEMBER SHETTLESWORTH: Can you explain the Loan Mix Index?

MR. MITCHELL: Sure. So the Loan Mix Index, what we did, is we actually looked at charge-off rates across almost every category of loan that's on the Call Report, so we have data for. And we looked at the charge-off rates and they were weighted by the number of failures in that year. And so what's come out of that is there's weightings each type of loan, so C&D has the highest weight, C&I is the second highest -- I'm going to lose myself after that in terms of rank ordering -- but they're all based upon what we looked at, charge-off rates during the time of stress, and that's how it's determined. And then what it does is simply take a look at your proportion of loans that are in those types of assets and it uses that multiplier to come up with a number that in and of itself isn't going to make sense if you just look at it. It has to be multiplied by the coefficient. It's not an intuitive number in terms of C&D loans relative to capital.

MEMBER SHETTLESWORTH: Can you share with us our specific ratings on all these ratios or is that all just inclusive of the overall assessment rate?

MR. MITCHELL: Could you repeat the question?

MEMBER SHETTLESWORTH: The leverage ratio is weighted, there's a certain category for that; I'm just curious if your model will tell you or you can share with us what our banks or other insurance divisions what their rating is in each one of these categories.

MR. MITCHELL: Oh, absolutely. So it's all on the public website where you can punch in your actual certificate and it will pre-populate every one of these factors.

MS. ELLIS: Everything but CAMELS.

MR. MITCHELL: Oh, true. Good point. Yes, you can do your own CAMELS.

MS. ELLIS: Yes, you can go to our website and you can download our calculator and it'll put all the Call Report data and you have to insert your own CAMELS. If you want to look at another bank, you can download all their public data and pretend what their CAMELS might be.

(Laughter.)

MR. MITCHELL: You can speculate.

MS. ELLIS: Yes, you can speculate and whatever, play around.

MEMBER TURNER: Do you know what weighted average CAMELS means? I understand CAMELS obviously, but weighted average?

MR. MITCHELL: Right, each one of the components is weighted; it's going to have a different weight. So management has a higher weight than liquidity. I'm forgetting asset quality has a higher and capital --

MS. ELLIS: Capital assets -- capital and management I think have the highest weight and then asset quality and liquidity.

MR. MITCHELL: Right, and asset quality, liquidity.

MS. ELLIS: It was a way of rather of using -- and this was in the old system too -- rather than just using a composite, it was a way to get a little more granularity, because you know, composite two -- I don't know, a great degree of difference sometimes in one composite two, versus another -- so using the components was another way of teasing out some of those differences in risk, and then weighting management and capital and assets heavier than the other is another way of getting more granularity.

MR. MITCHELL: Those weightings are the same that were in the previous rule, so those ratings have been pretty consistent over time.

Sure.

MEMBER HARTINGS: The leverage ratio, what's the tiering of that? Do you know where it affects you -- is that at 4 percent, 6 percent?

MR. MITCHELL: So assuming you're well-capitalized -- actually, it doesn't matter -- anyways, let's assume it doesn't matter -- assume you're well-capitalized, it really is every incremental dollar of capital or incremental improvement in the leverage ratio will result in a lower assessment, all else equal.

MS. ELLIS: But don't we have a floor? I thought it was like 8 percent. If you're below well -- all right, you're saying if you're below well-capitalized --

MR. MITCHELL: No, right. So --

MEMBER HARTINGS: So once you're well-capitalized you're at the minimum?

MS. ELLIS: Yes, once you're well-capitalized.

MEMBER HARTINGS: And then anything below well-capitalized is dollar for dollar?

MR. MITCHELL: So they all work together. And so it simply takes, if you're 8 percent -- let's say you increase your capital to 9 percent -- you hold everything else equal and let's assume you're not in the floor or the ceiling in terms of 3 or 30 -- so let's assume you're 5 basis points and you went from 8 percent to 9 percent, that will result in a lower assessment rate, all else equal. The same if you were at 8 percent and your capital lowers to 7 percent and nothing else changes, it will result in a higher assessment rate. So it is a multiplier. The interesting thing about -- if you want to look at it and do a pro-forma, you can actually change yours online; you can say what if I change my capital, how would my assessment rate change, you could actually show what that would do.

If it doesn't make sense --

MEMBER SCULLY: Jack, was your question, like if you're at 12, do you get a lower assessment than if you're at 10?

MR. MITCHELL: You do all else equal.

MEMBER SCULLY: Yes, all else equal.

MR. MITCHELL: But it doesn't mean you're at 3 basis points because it's going to look at all the other factors. If you had really high growth and/or you have low income and you have a risky loan mix, that doesn't mean you're going to be at the floor of those. It's just one component.

MEMBER HARTINGS: Well, if I'm at 12 and I go to 14, that will lower my --?

MR. MITCHELL: Yes, assuming, again, you're at a 3, assuming you're at a 4.

MEMBER SCULLY: Your shareholders may not like it...So Diane knows I'm going to say this is my last meeting and I'll beat this dead horse one more time.

MS. ELLIS: Yes.

MEMBER SCULLY: But the fact that the Loan Mix Index is the second most important variable, even above CAMELS, just suggests to me that at some point if you ever reconsider the weighting, I mean you're penalizing banks that have a certain business model, because it is ADC, C&I and I think CRE is --

(Simultaneous speaking.)

MEMBER SCULLY: If you're a commercial bank, my concern has always been since the first time I saw this formula, poor Diane has to listen to this every time.

MS. ELLIS: That's okay. You're not the only one.

MEMBER SCULLY: But this proves if it's the second largest factor that banks with certain business models, despite how well they execute on that business model, vis-a-vis their CAMEL ratings, are being penalized versus banks that have different business models. And I understand the history during the recession and so on, but I just want to go on record as saying it's a penalty for having a certain business model.

MR. MITCHELL: All else equal, I think that's true. I mean, you might also have additional -- you might also hold/retain additional capital or other things that would get reflected, and leverage ratio, and also non-performing loans.

MEMBER SCULLY: I shouldn’t have to do that unless you tell more openly that's what I should have to do.

MR. MITCHELL: Well, okay.

MEMBER SCULLY: And given that they're all 100 percent risk ratings, I would argue that if you're suggesting I should have a different leverage ratio because I'm a commercial bank, then why are they at 100 percent risk rating rather than 125 percent risk rating, which would be more consistent with that theory that business banks are always riskier than others. So I just --

MR. MITCHELL: Sure, okay. I mean, I think one of the challenges always, always true of coming up with a pricing system that is pricing over

5,000 banks and using statistical analysis.

MEMBER SCULLY: But look at -- and I'm going to just keep it up, I'm sorry -- there are eight majors here, and first of all, there's the CAMELS rating which to me is your opportunity, you finding you've really hit a granular level, examined a bank, you've give management a certain weighting; that's lower than Loan Mix, it's lower than non-performing loans, it's lower than OREO. I mean, intuitively it would seem to me that when you see the results of the formula and they suggest that that's the second most important thing, it might cause you to think do we have the factors weighted correctly. That's all.

MEMBER K. KELLY: I'll try to add a little color, if I'm hearing you correctly, Mary; she's basically saying if I -- and I'm going to put it in automobile speak -- if I buy a corvette at 18, let me know the insurance is going to be much higher than if I buy a Crown Victoria, regardless if I'm 50 or 18. So the point I'm trying to make is, I think the question is if my business model is more of a Corvette, I pay a little bit more of a premium versus if it's a Crown Vic, meaning a slower pace. And relative to those other factors that I think I have control over when I get behind the wheel, maybe my insurance rates deal is not reflected even though I'm a more conservative driver. It's kind of what I'm hearing you say; if not, tell me now.

MEMBER SCULLY: Yes, it's a basic premise that I have that there are certain things that indirectly will cause a reallocation of capital because these obviously, ultimately affect your profitability; therefore, it affects your attractiveness to investors.

MEMBER K. KELLY: That's right.

MEMBER SCULLY: So it is an implicit reallocation of the capital to banks that have a certain, or away from banks that have a certain business model.

MEMBER K. KELLY: That's correct. And so the question that I would have in following up Mary here, is to help us to understand which of those business models is a Vette versus which one looks more like a Crown Victoria.

MS. ELLIS: Well, I think this is sort of doing that, right?

MR. MITCHELL: I think so. I mean, that's one thing we hope to have very transparent. Again, you can disagree, but I mean even in the Loan Mix Index it shows to your point right or wrong, we can agree whether we should or not, but it shows that C&D is going to contribute more. We actually rank order them in terms of loans and then we also show the effect of increasing leverage, either increasing or decreasing your leverage. Your asset quality is a little more reflective of previous decisions, so that's going to just get reflected, but --

MS. ELLIS: I think if you fill out that profile, you would find that a bank heavily loaned up in C&D loans with thinly capitalized, growing rapidly with brokered deposits, they're going to be way -- that's the model that's going to get charged a lot in this system.

MEMBER K. KELLY: Got it, thank you.

MEMBER DONNELLY: Just a question on the modeling you have on the website, and before I throw rocks from this side of the table. Now, is that model -- because I played around with it -- is that model going to be something that I use as a tool or is it just something that's out there? I hate to be so direct but I'm going to be, because this is a pretty important piece, I think for everybody up here, it's an important piece to calculate, and if the rules are the rules, we need to know what they are. And go into budget, can I take that calculator online and I can depend on that other than the subjective -- well, management is subjective.

MR. MITCHELL: Yes, I think that's the primary purpose for this is so that you can plan --

MEMBER DONNELLY: Planning, you're going to have to get me with 95 percent of my -- I'm using that number, I don't want to pin you -- or maybe I do want to pin you down -- but to 95 percent accuracy on what my --

MR. MITCHELL: I mean, to the extent you were able to project accurately what your balance sheet and these components are going to look like, it's 100 percent accurate, because you know your own CAMELS rating. So it's only subject to that uncertainty; otherwise, it's completely transparent and you can see the absolute --

MEMBER SCULLY: And I would vouch for that; it is totally transparent, totally predictable, but what this does is it says it's not just me, it's saying that in the entire industry that has a very significant impact.

MR. MITCHELL: So I do want to talk about that a little bit, this is on average, and to your point there are some institutions where there are other factors that are a greater weight. So if you're a rapid -- if you have really rapid growth and you're 50-60 percent, that very well may be your top factor. Meanwhile, if you're making loans or you're less loaned up and you're making loans that we view as lower risk in the Loan Mix, then that Loan Mix Index may be lower than your contribution from your CAMELS and others.

MEMBER SCULLY: But on average.

MR. MITCHELL: This is on average rank order.

MEMBER SCULLY: On average business mix is the second greatest factor, above CAMELS ratings.

MS. ELLIS: Correct.

MEMBER SCULLY: Counterintuitive.

MS. ELLIS: Very correct.

MEMBER WILLIAMS: You know, I understand what you're saying here, but is there -- apparently there isn't any granularity, you don't get any more granular into that mix. For example, we talk about management's piece in this being an important factor, and management's piece in controlling and managing loan portfolios is an issue as well. Example, ADC; now, I can speak to some specifics, but you look at a company or a bank that has ADC, that's a category, but if you internally manage it to where they have a maximum of 7-1/2 percent of that is acquisition, another 7-1/2 percent maximum development, and the rest is vertical construction with a 6-month tenor and you're carrying extra capital; to me that's a portfolio risk factor that's a lot less than an ADC typical number you're using. So is there any way to take into consideration the management controls on the loan portfolio for those who have a business plan -- ours is the same way, it's a business bank -- but the controls are tighter than I've seen with a lot of large national banks that we've worked at. So I'm just saying granularity is an issue too; I don't know how you take that into consideration as you put these prices together.

MR. MITCHELL: One of our biggest challenges, and we try to remove effectively subjectivity from this, we try and use the data that we have, and we're limited by the granularity of the Call Report. I'm sure you're not suggesting we get more granular on that.

(Laughter.)

MR. MITCHELL: So it's a challenge, admittedly; and this is where I said we're pricing over 5,000 banks with one model. It's really required and it goes back to as an insurance company sometimes you're looking for certain predictors that -- I mean, could you have false positives, yes, could you have false negatives, absolutely -- but what we have seen is this, the pricing model that we put in place was a significant improvement over the CAMELS model. And part of that, one of the new components, one of the significant new components was the Loan Mix Index. I mean, one of the other things we're trying to do, and again, we can argue whether it's good or bad, is to look more forward and make sure we're pricing for risks as they're incurred. Those risks may or may not be realized, but as they're incurred we want to make sure as an insurance company we're charging for those risks as best we can.

MEMBER TURNER: I do think -- and at the risk I get shut down by my colleagues -- I do think the Call Report is overly broad in a couple of categories and you miss the risk a little bit -- and as I've said, we acquired five banks -- we probably from the FDIC we looked at, I don't know, 30 or 40 of them, so we have a fairly good feel of the kind of problems that cause that created failure in those cases. And not all ADC loans are created equally. If you're financing a senior care facility or an office building that's pre-leased, or a multi-family project that's got 30, and those things have 30-35 percent equity, that's a totally different risk profile than financing a piece of ground 100 percent for somebody that's hoping to sell it down the road. And those are the problems, at least in the banks that we ultimately acquired, those are the kind of loans that created big losses; it wasn't the former loans. And I agree with Mary Ann to a large extent, I think you're not taking -- as you weight the loan mix so heavily you're not taking differences in underwriting into account, too, and you have the ability to do that because you come in and examine us every year. And so if you have a loan mix that by this formula would indicate a little higher risk, but you come in and you have no bad comments about the bank's asset quality, they're one rated asset quality, it seems like you have an ability to maybe get a little bit more granular and a little bit more specific to a given institution. So I kind of agree, I think that's what you were saying, Mary Ann; I kind of agree. And it may be a question of whose ox is being gored because we have the wrong kind of loan mix, I can tell you that for sure. And so I'm sure we're paying a little bit higher assessment as a result.

MR. MITCHELL: So I would say -- and I understand your point -- I mean, I would say at the very least your asset quality rating certainly is included in there and is weighted.

MEMBER TURNER: Right, yes.

MR. MITCHELL: While it's third, it's not insignificant. These three all on average apply.

MEMBER TURNER: We just wish it was first.

(Laughter.)

MEMBER HARTINGS: Can I just ask one other question about the small bank assessment graph you showed us? You talked about once the $10 billion and over assessment falls off and goes back to about 20 percent, that's your best estimate today, is that the percentage of liabilities that those small banks have in the -- and is it 20 percent today?

MR. MITCHELL: It's close, it's roughly close.

MEMBER HARTINGS: Like close more or roughly close less?

MR. MITCHELL: No, I think it's actually a little bit higher right now. But it hasn't always. I mean, a couple percentage. I don't have exact so I don't want to --

MEMBER HARTINGS: So it pretty much runs that liability --?

MR. MITCHELL: It stayed roughly in line with the intention.

MEMBER HARTINGS: Okay, thanks.

MR. MITCHELL: So the last slide -- maybe this will be positive, we'll see.

(Laughter.)

MS. ELLIS: I think it's an act of goodness.

MR. MITCHELL: Right, exactly. Is again, talking about credits. So when the reserve ratio hits 1.35, then as I noted, then the large banks will stop paying surcharges. And once we hit the 1.38, credits will be applied to small banks. And those credits will offset to the extent whatever credits you receive, will offset in whole any of your assessments until they're exhausted. So we expect depending on your situation two to four quarters where you'll have your entire assessment offset. And it also depends on when we hit; we do expect either third or fourth quarter this year we will hit 1.35. And then you will receive -- you'll either see the amount of credits applicable to your institution on your invoice or we will separately notify; it all just depends a little bit on timing. Obviously, we need to get invoices out, but we need to make sure we're also, we're accurately and closely calculating the amount of credits. So you'll either receive it in your invoice or you'll receive it shortly after showing the amounts that are due to your institution.

MEMBER TURNER: That's positive.

MR. MITCHELL: It is positive.

MEMBER TURNER: So is that where you hope to keep it at 1.35, the fund?

MR. MITCHELL: Well, that's our minimum reserve ratio, so right now our designated reserve ratio, the long-range target is 2 percent. But what we anticipate after we hit 1.35 with the rates that I've shown you, we expect very slow but steady growth. And that's why we have to get above 1.3 -- well, in the rule we placed it at 1.38 to allow a little bit of breathing room. If we were to -- for some reason there were a high amount of insured deposit growth and/or combined with a failure and we were to go below 1.35, we would actually go back -- we would have to go back into a restitution plan once we go below 1.35. So it's important for us to hit 1.35, grow a little bit, provide ourselves some cushion, and that's why the delay until 1.38.

MEMBER HANRAHAN: Patrick and Diane, thank you for the explanation. At the risk of minimizing some of my colleagues' comments about potential model imperfections, which they're always in debate in any model, right?

MR. MITCHELL: Absolutely.

MEMBER HANRAHAN: I think this is overwhelmingly good news. Don't mistake me for a full-fledged fan of the Dodd-Frank Act, but I was really happy that the assessment base got changed from deposits to liabilities. I was really happy that the increase from 1.15 to 1.35 got put on the backs of the big banks. And any way you look at these numbers our cost of insurance has plummeted over the last several years. So I think it's 99 percent good news and I appreciate the explanation. Thank you.

MEMBER K. KELLY: I'll conclude my comments by saying good job in what you presented. I think it's apparent that you stated that there are statistical analysis that have come up with this model - you've done regressions on it in a way that you can clearly identify it to do more granularity and probably not get the same level of correlation. But what I thought I heard you say at the very end is there's kind of the Allstate model – we’re getting cash back.

(Laughter.)

MR. MITCHELL: That's right; I hadn't thought about it. I'm going to have to remember that one.

CHAIRMAN McWILLIAMS: But only if you're a good driver.

(Laughter.)

MR. MITCHELL: Actually, in this case we're indifferent as long as you're still surviving.

(Laughter.)

MEMBER K. KELLY: Thank you.

MR. MITCHELL: And again, I just reiterate, there's assessment hotline if you have any questions, if you want to go through any of your specifics or any specific questions, please reach out. We have people that this is what their job is to do, to make sure you're clear on what's driving your institution's rates.

MR. DAVIS: Great. Well, that brings

us up to another break. So we are scheduled to break from 2:30 to 2:45. We're about ten minutes ahead. My suggestion would be, if folks don't disagree, to come back at 2:35 instead of 2:45; that way either we wrap early or you have more time for the last session that a lot of people have talked about.

So we'll have a 15-minute break, be back here at 2:35.

(Whereupon, the above-entitled matter went off the record at 2:20 p.m. and resumed at 2:37 p.m.)

MR. DAVIS: Okay, I think we're ready for our last session of the day. For this session it is apparently the most anticipated session from what I gathered earlier.

We're going to discuss the interest rate restrictions applicable to less than well-capitalized banks. We have Associate Director Rae-Ann Miller back and joining her is Vivek Khare, counsel from our Legal Division. And I'll turn it over to Rae-Ann to start.

MEMBER TURNER: They brought a lawyer.

MS. MILLER: Given the level of excitement I thought it was the safest approach.

CHAIRMAN McWILLIAMS: Patrick is bringing a bodyguard.

MS. MILLER: Vivek and I are both from New Jersey as is David. There's a saying there you can't win for losing so we'll start the presentation with that.

So we wanted to talk to you guys today about interest rate restrictions, statutory interest rate restrictions. We touched on it a little bit this morning. I will say that the conversation was very helpful to us and I have taken down some notes about what the market is doing and really how it's changed.

And it's changing right now. I found that Joe's conversations about -- I think it was Joe -- mentioned doing a special and how you haven't done it in a long time. Was that you or was that Danny?

MEMBER TURNER: We have done specials.

But you know, I think what I was talking about was we hate to reprice our entire portfolio where you can be a little more targeted with a brokered offering.

MS. MILLER: So anyway, so as we go through I think a lot has changed and is changing. I mentioned this morning that we're going to be doing a broader rulemaking on brokered deposits in general and rate restrictions and so this conversation will be helpful for us there. And certainly when we do that we would welcome your comments.

So, in looking at the statutory interest rate restrictions and we put in your package a few things. We have the last time we changed the methodology in 2009 for calculating the rate restrictions. An article we did a couple of years ago.

And then I just put a little chart that I'll refer to later tracking over time what the rate restrictions have done.

So, just a little background as to why

we have statutory rate restrictions to begin with. So going back in time one of the things we do when we look at exam policy is how did we get here. And so we go back in time all the time and look and see why things were put in place.

And I have old manuals in my office and we have them in the library. I kind of go downstairs every now and again and look at our history.

And you start seeing references to brokered deposits and high rate deposits, rate sensitive deposits probably around in the nineteen seventies.

And if you remember right around late sixties, early seventies negotiable certificates of deposit were a new product at that time. And people, globalization in financial markets in general and people were seeking out rates and seeking out ways to park excess funds at the highest rate possible.

That was really the first time you started seeing people going outside of their local bank to take cash balances and invest them. And at the same time there was really a democratization of the brokered dealers and people having brokerage accounts and not just for the rich people.

You saw a lot of disintermediation, a lot of globalization in money management. And you start seeing that in exam instructions and annual reports about the flow of funds.

So, along with that you started seeing some issues. And I would agree with Joe that certainly not all banks that have brokered deposits are high rate deposits. In fact most manage those just fine and it's part of an overall strategy.

But throughout time there is a linkage between institutions that have used brokered deposits and use high rate deposits for excessive risk taking, excessive growth and those institutions have cost us a lot of money on the back end.

When you start going into the nineteen eighties we had the banking and thrift crisis as you know. Looking at the annual reports and some of the other reports that were produced regarding the crisis as that was unfolding many of the failures and problem institutions had heavy levels of brokered deposits.

If you remember Penn Square was a famous large spectacular failure. Over 80 percent of its deposit base was basically brokered and high rate funds.

And what would happen was there was a pattern. The institution would basically call up and get all the funds it wanted, do high risk deals with those funds, get in trouble and then get more funds to try and grow out of its problems.

And at the end of the day those were very, very costly to us. Acquiring banks typically don't pay at all for brokered deposits and in some cases we actually do not even pass those. We have to pay those off. So that was sort of the history of the problems.

So, in 1989 with FIRREA, Congress basically instituted restrictions on brokered deposits and high rate deposits. And at the time when you look -- and Vivek has looked a lot more at the congressional history than I have, but the issue with the high rate deposits was that banks were basically serving as their own money desks.

Even if you had brokered deposit restrictions the concern there was well the bank will just assign some employees to just dial for dollars basically and call and get as many deposits as they want.

So they instituted two restrictions, brokered deposits and high rate deposits.

So those have been in place since 1989. And then in 1991 with FIRREA the restrictions were then linked to the prompt corrective action framework.

So you had automatic restrictions kick in. And it's one of the first things that kicks in basically when an institution falls below well-capitalized.

So the purpose of the restrictions basically are threefold. I think somebody mentioned our report that we had done after the

Dodd-Frank Act was passed on -- it's called the Core and Brokered Deposit Study and we talk about basically three things that the brokered deposit restrictions and the rate restrictions are there for.

Number one is to prevent rapid growth on the upswing. Rapid growth that's not well absorbed by the institution.

So what we saw in this last crisis was institutions growing very, very fast with brokered deposits, with high rate deposits and imprudently investing those funds in mostly CRE but oftentimes CRE and out of area CRE and things that it probably didn't have experience in.

The second thing is volatility. This is what we hear often as well. It's hot money. This money is not hot. How can it be a brokered deposit if it's not hot money?

Well, especially with the deposit insurance limit at $250,000 not all brokered deposits are necessarily hot money or high rate deposits or hot money. They might not be volatile because the person might just be seeking deposit insurance. But again how did they use them on the way up.

And then the third piece and the reason brokered deposit and high rate restrictions are in place is franchise value. What are those deposits worth if the bank fails? And brokered deposits and high rate deposits really don't fetch the same type of -- if anything the same type of money when the bank fails.

So I was going to turn it over to Vivek to talk a little bit about the legal framework and how the law and the regulations that we have interact.

MR. KHARE: Thanks, Rae-Ann. Yes, I'm going to get into the legal framework around the rate restrictions and hopefully that will provide you with some context when we get into our discussion.

So as Rae-Ann mentioned the statute, the first thing I'll talk about, section 29 of the FDI Act was enacted in 1989 via FIRREA and it set forth two types of restrictions. The first restriction is that less than well-capitalized institutions may not accept, renew, or roll over brokered deposits unless they receive a waiver if they're adequately capitalized.

And the second restriction which is going to be our focus here today is that less than well-capitalized institutions are limited or restricted on the amount of interest that they may pay.

So the statutory interest rate restrictions are based upon capital category and can be summarized as follows.

Well-capitalized institutions can pay any rate they wish on any sort of deposit. Adequately capitalized institutions generally may not pay rates of interest that are significantly higher than the rates offered in the institution's normal market area or the national rate.

And undercapitalized institutions similarly may not pay rates of interest that are significantly higher than either of the following, the rates in the institution's normal market area or the rates in the institution's market area from which deposit is accepted.

So as you can see the statute sets a general framework but it really doesn't provide some key details. For example, it doesn't define some of the terms that I just mentioned such as what does it mean to provide a rate that is quote, "significantly higher," and what exactly is an institution's market area.

And of course most importantly what is the methodology that gets you the national rate.

So this brings us to our rulemaking and then through two regulations -- one in 1992 and again in 2009. The FDIC has implemented these statutory requirements and defined these key terms after engaging with the industry and other key stakeholders.

I'll start in 1992 the FDIC defined the term “significantly exceeds” as 75 basis points. This would provide IDI subject to the rate caps an opportunity to compete for funds within markets by paying 75 basis points over the national rate for their local market rate while also restricting their ability to attract funds by paying rates significantly higher in accordance with the statute than prevailing rates in their respective markets.

As part of that '92 rulemaking, the FDIC after review of multiple options during the rulemaking process calculated the national rate as 120 percent of the Treasury yield curve and 130 percent of the yield curve for wholesale deposits.

The FDIC at the time decided to couple the national rate with the Treasury yield curve because it allowed for greater flexibility should the spread to Treasury securities widen in a rising interest rate environment. And most notably at the time we just didn't have the data. We didn't have reliable accurate data that was timely whereas Treasuries were being provided on a daily basis.

And so for many years the definition functioned reasonably well. The Treasury rates tracked closely with the rates on deposits so troubled banks could generally pay up to 75 points above the Treasury yield curve.

However, leading up to the recent financial crisis the rates on certain Treasury obligations lowered significantly compared to deposit rates and consequently the national rate that was pegged to the Treasury yield was artificially low thereby restricting access to even market rate funding for less than well-capitalized banks.

In response to this issue and as part of the 2009 rulemaking the FDIC redefined the national rate as what it is today, a simple average of rates paid by all IDIs and branches for which data are available.

This was done again primarily because data was finally readily available to provide a true objective national rate.

Today the FDIC gathers national rate information from up to 80,000 main office and branch locations and publishes specific product rates weekly on its website.

The published account types and

maturities are those most commonly offered with two rates provided for each maturity, one jumbo, one non-jumbo.

In addition and as part of that 2009 rulemaking the FDIC developed a presumption that the prevailing rate in any market would be the national rate.

This approach recognized with the increasing prevalence of internet deposits and internet advertising of deposit rates, price competition for deposits has become more national.

Moreover, this approach recognized and avoided the considerable practical difficulties that can exist with trying to figure out the boundaries of a larger institution's normal market area and then attempting to dissect the prevailing rates paid within that area.

While the 2009 rulemaking presumed the national rate applied across the board for less than well-capitalized banks, the FDIC also provided a rebuttable presumption for banks that sourced deposits solely from their local market area.

This was known kind of as a community bank exception. So if an IDI believes that the prevailing rates in its local market area are higher than the national rate they could come to our FDIC regional office, provide evidence to the regional office that the local rates are higher than the national rate and then the institution will be able to pay 75 basis points over their prevailing local market rate.

In evaluating this evidence that the banks provide, the FDIC can use segmented market rate information and also can consider evidence as to the rates offered by credit unions if the IDIs are competing against credit unions in their local market area.

Finally, the FDIC may consider evidence that the rates are based on certain deposit products, such as NOW accounts, and whether those accounts differ from rates on other products such as MMDAs.

So this option has given some flexibility to community banks that are competing in a local market area and particularly now because we see a little bit of a crunch with the national rate.

So that's where we are today. We have undertaken these two rulemakings to try to clarify and update our restrictions but with that we still see some new issues and see some reemerging issues which Rae-Ann's going to talk about.

MS. MILLER: So yes. We put a chart in here on the last page of your packet for our presentation. I just want to refer you to that.

And what this depicts here, this is a wholesale CD, a 12-month CD product. And what we tried to do was show you what the rate caps look like under the old methodology which is the red dotted line if we were to have maintained that.

The new methodology that we instituted effective in 2010 is the green dashed line.

And then the blue line depicts sort of a proxy for high rate payers. And this is from a listing service that you've probably heard of, just the top 10 payers. To stay competitive and to get wholesale funds you really have to be one of the first names that folks see.

So you can sort of see how we -- the high rates CDs sort of tracked for a long period of time the Treasury rate. We didn't shade recessions, we probably should have, but in the early two thousands you'll see that Treasury dips down below a little bit. That's probably a rush to safety.

And then we kind of track again the shape of the Treasury until the 2007 disruption when a huge rush to safety really drove yields down on Treasuries.

So at that time I didn't have this job but at the time we were processing hundreds of local rate determinations, the community bank presumption that Vivek talked about.

Banks were running -- that were less than well-capitalized that may have had some viability issues were running out of options because they were running into a liquidity crunch because when the rate restrictions crunch you they will crunch you fast and that was what was happening.

So we went out, made this change and as you can see the green dotted line which is the national rate based on this survey. And we get this survey from a company. We talk about the name of the company on the website and publish it weekly.

And it is indeed -- it's a survey of all banks and branches that offer the particular product. So a one-year CD is probably one of the most common products. I think it has something like 60,000 votes if you will about banks and branches that offer them in order to hit the national rate.

So you'll see here this green line for a number of years after the crisis was above the blue line. So banks that were less than well-capitalized were able to access funds from listservs or other high rate sources without much problems.

They might have been shut out from the brokered deposit market, but they could still get high rate deposits.

Well, that changed in 2015 when the Fed started raising rates. And what happened at that time was institutions could no longer compete. The rate restrictions started -- the rate caps started becoming binding on those institutions.

And so we did have a few failures and problems of institutions that sort of caught them suddenly. We hadn't been dealing with rate restrictions for a number of years.

So we certainly -- one of the things Dave said early in the presentation was and maybe some others did was, "Gee, we have started focusing on the right side of the balance sheet."

Well, as examiners we had not focused on the right side of the balance sheet. We were dealing so much with the left side and with the hangovers of CRE and other problem loans that we sort of lost our evaluative focus on the right side of the balance sheet.

But we had these few institutions that sort of be-bopped along and were able to stay alive this way but really did not have prospects. And a few failed and cost some money and we were lucky with a few others.

Sort of reinvigorated our training of examiners. Remember that this is an issue when you're talking with bankers you need to make sure they understand that this is an issue.

We did this article as well to remind institutions.

So flash forward, that's sort of 2015, 2016. As the market has continued to rise, the national rate has come up a little bit but not very much. And so we are thinking of ways, things that we could do and questions that we could ask to see whether the methodology that we're using is still the appropriate one.

It's certainly not the only one. I keep picking on you but I would disagree with you that there's something wrong with it. I think it's a mathematically accurate calculation. Now whether it's the only one or the most appropriate one remains to be seen. So something certainly that we're looking at and would be interested in with our rulemaking later this year.

So I think with that maybe we'll pause and see where you guys are.

MEMBER SHETTLESWORTH: From an impact standpoint, do you see this rate cap impacting larger institutions or is this more the smaller institutions? I'm concerned that there's a potential of unfairness out here.

I understand why we're managing this, but the large banks have a lot more access to a lot different types of liquidity than I do. So I'm just wondering if this is overly penalizing the small banks.

And I also realize it's based on what the deposit insurance fund lost with small banks. But if the largest banks wouldn't have had a capital injection we would have had -- their losses would have wiped out.

MS. MILLER: There is a reason for the rate restrictions. Failures are costly. We don't want banks trying to grow out of their problems.

But that being said the reason why

there's not significantly over the prevailing rate is those banks do have a chance to compete if they are having a problem to try and find capital, to try and work out of their problems without aggressively growing.

I don't know that it necessarily penalizes small institutions. But the way it has been calculated has certainly not been helpful if that's any.

MEMBER SCULLY: I think one of the concerns, maybe two of the concerns is what are the appropriate indices. And is it really possible to say there's a national cap as opposed to putting institutions into regions where there are great differences that can be impacted by competition.

But I think the reason that so many people are focused on this right now -- because if everybody thought this was only going to apply to less than well-capitalized institutions I think most people would say, "Oh well, that's never going to be me, I'm not worried about that."

But the danger is that this definition

of an instrument that carries a rate above a national cap will at some point be swept into this evolving definition of high volatility deposits.

There's already a lot of discussion -- not any kind of even official guidance on that -- but I think a lot of us when we've had recent examinations on the liquidity side have heard about this high volatility deposit definition.

Not to beat my business model drum again, but if you're a commercial bank and you've got a lot of commercial deposits, you have a lot of deposits that are over the FDIC insurance limit. They're certainly what we would view as core deposits, but they count as high volatility deposits in these new definitions.

And so I think the overall concern is does this category that we've always thought of as only applying to troubled institutions now somehow get swept into another category that could affect all institutions.

And maybe the -- one's a suggestion, move away from the national caps, but the other is more of a question to you in terms of does this then become quite naturally something that's extrapolated into oh, and this is also a high volatility deposit because it's carrying an interest rate that's significantly above a national cap.

MS. MILLER: Can I add that you're also in a metropolitan area that probably pays higher rates.

MEMBER SCULLY: Well, we have a lot of credit union competition. And I never know if IDIs count. People insured by NCUA or only FDIC. If it doesn't count NCUA, you're definitely not capturing the highest rates.

MEMBER DONNELLY: Question. You made a comment, Rae-Ann, and I appreciate it. I think it's helped me on this because this is a concern of mine.

The concern to the loss to the fund because the brokered deposit has no value at the sale, that is higher weighted than the liquidity that they'll provide me before I close. Is that an accurate statement? And I hope that makes sense.

MS. MILLER: No, it does not so can you repeat the question?

MEMBER DONNELLY: Sure. I heard you say that the brokered deposits have no value at the sale. That's after the bank's been liquidated.

So that seems to me to be a higher value to the FDIC versus the liquidity available to the institution before it fails.

MS. MILLER: I don't think that's quite fair to say that but I think that's what Mary Ann is saying by this term which is not an official definition of high volatility but I agree that as examiners we have probably relied on that too much. And we're working on that certainly with the instructions.

It's a balancing act because it does -- brokered deposit, high rate deposits are part of many institutions' business model and used appropriately and provide appropriate liquidity.

But the restrictions are there for a reason and the reason is our history of having problems with them being used imprudently and not getting the appropriate value when it fails. It's not that one is more valuable than another.

MEMBER DONNELLY: And just from my perspective coming in and playing cleanup is a whole lot easier looking backwards and having 20/20 than it is while you're there in the heat of the battle.

Seeing a bank that's funded with local CDs at the highest part of the market, absolutely the highest funding in the market when brokered deposits are different than that.

And as soon as that institution gets into trouble, those CDs run off just as fast as anything else from a liquidity standpoint only, not from a safety and soundness and can I sell it tomorrow perspective.

That is so evident. As soon as you lower those rates those things are gone. And then the value has got to be lower when they're priced higher than market and you can come in after the sale, after the close and reduce that the one time whatever that is.

MS. MILLER: You make a good point. We caught the tail end of Pat's presentation on the pricing model. So although it's unusual for a community bank apparently to be penalized for brokered deposits it could happen.

But high rate deposits aren't necessarily factored into that calculation. That's something else for the rulemaking. Are we hitting the right note there?

Certainly when we look just at cost of funds and look at 90 percentile payers, 95 percentile payers they are as likely to fail as institutions that are heavily reliant on brokered deposits.

MEMBER HARTINGS: Can you answer the question how do the credit unions pricing fit into the IDIs? Is that part of it?

MS. MILLER: I can answer. Oh, you want me to?

We don't calculate credit unions in the national rate but community banks, or really any bank. We call it the community bank exception because that's typically who uses it.

But if a bank is paying in its local rate area a bank that's less than well-capitalized and wants to show us evidence of where they are on the rate-paying scale they can use credit unions as an example. And often do.

MEMBER HARTINGS: And why don't you?

MS. MILLER: Well, you know, I think going back in 2009 we didn't give a real good reason as to why we didn't. I think perhaps at the time we did not have the same ability to gather that data with credit unions.

The service that we use is primarily a bank gathering service but certainly again it would be something that would be of interest. Certainly when you look at the services and you want to find the highest CD rate you will see credit unions appear along that list with banks.

MEMBER MENON: You also use the rates that are posted nationally by online banks like Synchrony and banks like that?

MS. MILLER: So, the national -- no.

The national rates are done through a service that actually, I don't know if they call around or they have a call-in sheet or whatever but they do all branches and all offices regardless of whether they're -- we don't just look at high rate payers.

And another thing that made me think when you asked that question is, and this is why I was asking Joe that question about specials is we don't include special features. And I think in this market something we were talking about before we came in is the rate that's posted or the rate that they might answer to you on for this company is the 12-month jumbo CD at 25 basis points. That's what they advertise.

But they're running a special on a 13-month jumbo at 3 percent and that doesn't get captured. And I think that's something that's changed and that's much more prevalent than what was envisioned in 2009.

MEMBER TURNER: And if somebody were to come in the branch and say they were getting ready to move, they were going to pay more than 25 basis points. So it's not really reflective of what the market is.

I think you guys did a terrific job of explaining the regime. I feel like I understand it now. And I understand where the FDIC is coming from.

If I was in your shoes though the last thing I would ever want is a bank to fail as a result of lack of liquidity that was otherwise viable because the FDIC is going to lose money every time on that bank when it fails.

So I would be trying to -- now, you don't have the ability. The statute specifies that these things will be prohibited. It's your job I guess to define what substantially in excess of the market is.

So you've got to identify what's the margin over the market and then what's the market. It seems to me the margin over the market should probably vary based on what the market is.

The higher the market rate, the higher the margin should be probably. And then the market because of what we talked about you've got, whatever, 3,000 Citi Corp branches factoring into that number and they're three basis points or whatever they are on everything.

I don't know, that's a hard question.

MS. MILLER: Tell me about it. Mary Ann mentioned what do you use as an indices. We call it the peg. Where do you set the peg is an issue.

Interestingly if you just reduce -- currently anyway if you just reduce it to main office, so Citi or B of A doesn't get 10,000 votes or whatever you don't get that much of a lift just because just overall rates are super, super low.

There's the 75 basis points. Could it be something sliding?

There's two issues when you said as the FDIC we wouldn't be somebody where a viable institution failed because of this.

We were also in this period of time when interest rates were artificially low where banks were staying afloat and not having to make the hard choices.

There's a reason why there's rate restrictions is because you're in trouble, you've got to do something to fix this problem. So it also served when we had very low interest rates to sort of help those institutions stay afloat which probably should have made those hard choices and fired management and shrunk and done those things and they didn't have to do that. So it's a balancing act.

MEMBER DONNELLY: I think Jack talked about credit unions. I'd really -- I'm not here to bash credit unions today but it's -- you look at my QwickRate portfolio it's all credit unions, 100 percent. So I'm basically funding them to outbid me on the CD and buy it back.

(Simultaneous speaking)

MEMBER DONNELLY: -- they've under bid me on.

But if you discount that in the picture you're missing a huge piece of the big picture and it's evolving so rapidly as we speak in the Synchrony Bank and all those. Those things, the evolution is so quick I don't think we have 10 or 15 years to deal with it. I think it has to be dealt with in a much compressed period of time because that's getting worse instead of better.

I really think that needs to be somehow added.

MEMBER HARTINGS: Joe mentioned the differential as rates go up. But as rates are moving there's -- when rates seek that level there's not as many specials, not as much kind of cloak and dagger out there.

And you've got to figure out somehow how to consider that in this formula because I would tell you right now your rate survey is not a very good survey because you're not capturing. Stuff's going like this and they're hiding it here, they're hiding it there. We're all trying to figure out how to do it.

Now, once we get up to that level we stay there for six months, eight months, a year, it all kind of levels out. But this is really, your rate survey is probably not capturing today what the rate's really doing out there.

MEMBER HANRAHAN: Rae-Ann, I found the history very helpful. Shame on me. I did not know that the methodology changed in 2009 so that was good information to have.

I'm glad that FDIC saw fit to make a change in '09 when it stopped not working perfectly. And it seems like FDIC is open to consider other changes now as a result of the RFP that's going out.

This chart I think really tells the story. And one of the reasons I do conclude there's something wrong with it is if a bank that's paying a rate less than half the cost of the rate at which the U.S. Treasury borrows money how could that be regarded as a high rate? Does that mean the U.S. Treasury is overpaying by two times?

It just seems to me on its face to be not working right.

MR. DAVIS: Any other questions?

MEMBER DONNELLY: Nobody else wants to put their neck out there.

MS. MILLER: How do you follow that?

MR. DAVIS: Thank you very much. That concludes the panel for today so I'll turn it back over to the chairman for closing remarks.

CHAIRMAN McWILLIAMS: Thank you, Chad. Thank you, Rae-Ann and Vivek.

So you definitely listened to my suggestion not to fall asleep this afternoon. Thank you all. This was incredibly valuable and I just want to take a minute to say goodbye to the old friends and welcome the new ones to the committee. And I'll turn it over to Marty for the closing remarks.

BOARD DIRECTOR GRUENBERG: I don't have much to add. Let me take the opportunity to thank Mary Ann and John and Jack and Chris for their service as well as to welcome our new members.

I'm really struck again with the quality of the conversations we have and the value of the input that you provide to us. It's really thoughtful and nuanced and you don't always agree with one another which makes it even more valuable from my standpoint.

I thought I'd like to commend the chairman for having the round table, adding the round table to the meeting this morning. I thought that was as fine a seminar on community banking that I've ever participated in. I learned a great deal. And it adds a lot of value to the agency. So thank you all.

CHAIRMAN McWILLIAMS: Thank you.

(Whereupon, the above-entitled matter went off the record at 3:16 p.m.)