The Meeting of the Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

July 20, 2016 – 9:00 A.M.

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

The members of the Committee present at the meeting were: Cynthia L. Blankenship, Vice Chairman and Chief Operating Officer, Bank of the West, Grapevine, Texas; Pedro A. Bryant, President and Chief Executive Officer ("CEO"), Metro Bank, Louisville, Kentucky; Leonel Castillo, President and CEO, American Bank of Commerce, Provo, Utah; Christopher W. Emmons, President and CEO, Gorham Savings Bank, Gorham, Maine; Jane Haskin, President and CEO, First Bethany Bancorp, Inc., Bethany, Oklahoma; James Lundy, CEO, Western Alliance Bank, Phoenix, Arizona; Mary Ann Scully, Chairperson, President and CEO, Howard Bank, Ellicott City, Maryland; David Seleski, President, CEO and Director, Stonegate Bank, Fort Lauderdale, Florida; Gwen Thompson, President and CEO, Clover Community Bank, Clover, South Carolina; John Tolomer, President and CEO, The Westchester Bank, Yonkers, New York; and Derek Williams, President and CEO, First Peoples Bank, Pine Mountain, Georgia.

Roger Busse, President and CEO, Pacific Continental Bank, Eugene, Oregon; Jack Hartings, President and CEO, The Peoples Bank Co., Coldwater, Ohio; Mark Hesser, President, Pinnacle Bank, Lincoln, Nebraska; and Arvind Menon, President and CEO, Meadows Bank, Las Vegas, Nevada, were absent from the meeting.

Corporation staff who attended the meeting included: Willa M. Allen, Ruth R. Amberg, Frank M. Blanchard, Julianne F. Breitbeil, Luke H. Brown, Michelle L. Cahill, Christine Davis, Debra A. Decker, Patricia B. Devoti, A.T. Dill, Willie B. Donaldson, Doreen R. Eberley, Diane Ellis, Shannon N. Greco, Nicholas Kazmerski, Katie L. Kramer, Eun Si Lee, Christopher Lucas, Greg A. Lyons, Michael S. McCoy, Gregory L. McElroy, Roberta K. McInerney, Jonathan N. Miller, Rae-Ann Miller, Patrick M. Mitchell, Mark Moylan, Sumaya A. Muraywid, Faye Murphy, Shayna Olesiuk, Mark E. Pearce, Sylvia H. Plunkett, Lee Price, Claude A. Rollin, Barbara A. Ryan, Stephen H. Simpson, Robert Storch, Gordon S. Talbott, Rachel A. Ursery, Lester P. Washington, James C. Watkins, and Mindy West.

William A. Rowe, III, Deputy to the Chief of Staff and Liaison to the FDIC, Office of the Comptroller of the Currency was also present at the meeting.

Chairman Gruenberg opened the meeting by welcoming the Committee members and participants. He began by acknowledging the following committee members for whom this will be their last meeting: Cynthia Blankenship, Vice Chairman and CFO of Bank of the West, Grapevine, Texas; Pedro Bryant, President and CEO, Metro Bank of Louisville, Kentucky; Lionel Castillo, President and CEO of American Bank of Commerce, Provo, Utah; Jane Haskin, President and CEO, First Bethany Bank Corp, Bethany, Oklahoma; Mark Hesser, President, Pinnacle Bank, Lincoln, Nebraska; James Lundy, Chief Executive Officer, Western Alliance Bank, Phoenix, Arizona; David Seleski, President, CEO, and Director of Stonegate Bank in Fort Lauderdale, Florida; and Derek Williams, President and CEO of First People's Bank, Pine Mountain, Georgia. Chairman Gruenberg expressed his personal gratitude to each of the departing Committee members and commented that each has made important contributions to the Committee and has enhanced the FDIC's appreciation of the challenges and opportunities facing community banks.

Chairman Gruenberg then provided an overview of the meeting agenda. First, a summary update would be provided on the FDIC’s Community Banking Initiative and the Community Banking Conference. Next, a panel would be presented with the intent of providing a better understanding of the perspectives of millennials on banking. Following that an update would be provided of the FDIC's regulatory review under the Economic Growth and Regulatory Paperwork Reduction Act (“EGRPRA”). The next panel would cover issues relating to consumer compliance, including an interagency proposal being developed under the FFIEC to revise the existing Consumer Compliance Rating System to better reflect the current consumer compliance supervisory approaches. Next, there would be a discussion concerning developments in financial technology. Following that a panel would present recent supervisory developments, including recent updates to FDIC IT examination procedures to provide a more efficient, risk focused IT examination approach. In addition, senior staff from the Division of Risk Management Supervision (“RMS”) would provide the Committee with an update on some recent developments with the Financial Accounting Standards Board (“FASB”). Finally, senior staff would provide the Committee with some information about the interagency proposal concerning incentivized compensation and brokered deposits.

Chairman Gruenberg then introduced Barbara A. Ryan, Chief of Staff and Deputy to the Chairman and Chief Operating Officer, who would be the moderator for the day’s proceedings.

Ms. Ryan introduced the panelists for “Updates on Community Banking Initiative and Follow-Up from the Community Banking Conference,” Doreen Eberley, Director, RMS and Mark Pearce, Director, Division of Depositor and Consumer Protection (“DCP”). Ms. Eberley began by discussing ongoing FDIC initiatives, including the recent addition of a technical assistance video on corporate governance. Ms. Eberley stated that they were looking at updating and possibly adding to the Directors' College portfolio of videos. She indicated that over the course of the next few weeks, copies of the Community Bank Resource Kit would be mailed to FDIC supervised institutions.

Ms. Eberley next mentioned the discussion at the community banking conference concerning de novo banks and what steps that the FDIC was taking to be more helpful in the formation of de novo institutions. One item Ms. Eberley pointed out in particular involves hosting roundtable meetings with organizing groups around the country starting with three regions, San Francisco, New York, and Atlanta, with the San Francisco roundtable meeting to begin held on September 28th. Ms. Eberley specifically thanked and recognized John Tolomer for his suggestion of using a panel of successful de novo bankers as part of the sessions. Ms. Eberley pointed out that this way the panel can discuss the process and the best ways to approach it, their experiences, what worked, what lessons were learned along the way and take questions.

Ms. Eberley pointed out that the FDIC maintains a special page on fdic.gov for mutual institutions. She also mentioned that every other year the FDIC hosts a mutual bank conference jointly with the OCC and the Federal Reserve, the next conference is scheduled on August 4th.

Ms. Eberley then discussed the work streams coming out of the community banking conference relating to schools that are offering banking degrees and finding a way to facilitate conversation between those schools, bankers, and state banking associations, about how they could work together. Ms. Eberley stated that she envisions the FDIC role as bringing the parties together. Ms. Eberley next mentioned that the FDIC is working on its handbook for deposit insurance, which will be available later this year. She pointed out that in the meantime, the FDIC might be having a shorter article in the next version of Supervisory Insights discussing the process and outlining it.

Ms. Eberley next discussed the FDIC's ongoing work regarding technology service providers. In this regard, she indicated that the FDIC is actively working on ways to ensure institutions are able to partner with their technology service providers in an equal way. Ms. Eberley also mentioned that FDIC guidance applies both to the institutions serviced by technology service providers and the technology service providers themselves. In this way, the FDIC is continuing to explore ways to help with that relationship and make sure that institutions are well positioned to perform necessary due diligence and manage those relationships.

Ms. Eberley pointed out another way the FDIC is working to increase transparency in IT examination is through the new Information Technology Risk Examination Program (InTREx). She explained that one of the purposes of the new program is to better allow institutions to understand the rating system and the components of that rating system. Ms. Eberley went on to state that the work program has been redesigned and now aligns with the rating system again with the idea of increasing transparency and understanding.

Finally, Ms. Eberley mentioned that the FDIC was conducting research into the pressure that institutions felt to provide liquidity to shareholders and the different ways that institutions are addressing that. Ms. Eberley then tuned the presentation over to Mark Pearce to provide a perspective from the Division of Depositor and Consumer Protection.

Mr. Pearce began by pointing out that DCP has updated certain Technical Assistance Videos including those dealing with flood insurance and later this summer the ability to repay rule and qualified mortgage videos would also be updated.

To better support community banks in the mortgage area, Mr. Pearce stated that the FDIC is providing information about how community banks can access affordable mortgage programs. He added that there are programs at the state level through state housing finance agencies. Mr. Pearce mentioned that Federal Home Loan Banks have a series of programs that community banks can access and there are also various Federal programs like USDA or FHA. Mr. Pearce pointed out that the FDIC has been working for some time to learn how community banks have and are utilizing these programs to serve customers and doing research to put together a resource guide for community banks on affordable mortgage programs. Mr. Pearce mentioned it is his hope that by later this summer the FDIC will publish a resource guide that that will cover a whole series of federal programs and the opportunities in those programs, some potential risks or concerns for those programs, and also some stories from community bankers about how they have actually utilized those programs.

Finally, Mr. Pearce mentioned that over the last couple of years the FDIC has been trying to improve the risk focusing aspect of the pre-exam planning process. Mr. Pearce explained that the intent is to make sure that by the time the examiners get on site at the bank, they have a good understanding of the bank's risk profile, complexity and business model. He said that there has been positive feedback so far on this program.

Ms. Ryan then invited questions or comments for the panel.

Member Tolomer commented that the video on corporate governance was excellent and would both be helpful for de novo as well as current boards.

Member Lundy commented on the information provided regarding flood insurance. He indicated that his bank has had issues arise with flood insurance related to contents not being covered. He went on to explain that there are instances when flood insurance is taken on the building, but not on the contents. This, Member Lundy explained, is creating a situation of unintentional technical violations of the flood insurance policy. Mr. Pearce stated that the FDIC is working to try and make sure that technology service providers are providing software or disclosure forms in a way that helps support community bank compliance, not just technical compliance.

Member Blankenship commented that the Community Bank Resource Kits were excellent and have also received positive feedback from her bank's board.

Ms. Ryan then introduced the next panel "Millennials' Perspective on Banking." The intent of the panel, Ms. Ryan explained, is to provide the Committee a perspective from Millennials on their attitudes toward banking and how they generally access and use financial services. Ms. Ryan introduced the members of the panel: Stephen Simpson (moderator), Senior Financial Analyst in the Division of Insurance and Research ("DIR"); Frank Blanchard, Economic Analyst, DIR; Greg Lyons, Student Trainee, DCP; and Michael McCoy, Student

Trainee, RMS. Each member of the panel provided a brief summary of their respective experience and background.

Mr. Simpson began the presentation by going through a slide presentation entitled "Millennials Shaping the Future of Community Banks." Mr. Simpson mentioned that the idea behind this discussion came from the April 2016 Community Banking Conference in which four main themes emerged relevant to how millennials view banking. The first theme, Mr. Simpson explained, was the shift in focus on the generations and the differing banking needs, primarily the discussion was between baby boomers and millennials. The second theme was the differing styles of communication and related expectations of millennials. Mr. Simpson then explained that the third theme was the dynamic landscape of technology and its role in banking. The final theme, Mr. Simpson stated, concerned millennials in the workforce and attracting and retaining talent.

Mr. Simpson defined the term "millennial" as the population born between 1980 and 2000. He went on to state that using the definition of being born from 1982 to 1998, the most recent full estimate available from the U.S. Census Bureau, identifies the millennial population at a little over 74 million as of July 2015 which is about 23 percent of the U.S. population and places them in the same category as baby boomers in terms of overall size. Mr. Simpson explained that not only is the sheer size important, but also the demographic is rapidly approaching a critical life stage where the youngest millennials are approaching financial independence and the older millennials are rapidly approaching their prime earning years. This, Mr. Simpson stated, makes millennials a target market.

Mr. Simpson then explained what distinguishes millennials from prior generations. First, he pointed out that according to U.S. Census data, in 1975, three out of every four 30 year olds held a job, owned a home, and had started a family. By 2015, the share of 30 year olds that had tackled those same life events fell to just one in three. Mr. Simpson pointed out that is has been a significant change and according to a 2015 Pew Research Study, it is taking millennials a little bit longer to figure out a defined career path and longer to get married.

Mr. Simpson reported that the Pew Study shows millennials have a tendency to live in city centers, be more educated or at least attain higher levels of education and save more than previous generations. He then stated that millennials have a tendency to be socially connected, having been raised on social networks and tend to care about social issues. Importantly, he pointed out that millennials are more comfortable trying out new technologies. From this data, Mr. Simpson drew some key trends; first housing formation had been affected due to the delay in marriage, which affects the timing of the initial home purchase and subsequent home purchase. Second, urbanization, housing affordability and preference have pushed millennials into city centers. This is not only affecting home buying, but also car buying, i.e. the millennial living in the city is less likely to need to buy a car, and even less likely to buy multiple cars. Another trend is that increased education is leading to more student loans. Two thirds of bachelor degree recipients have outstanding student loans with an average debt of about $27,000. This compares to two decades ago where only half of recent graduates had college debt, and the average was around $15,000. Mr. Simpson explained that this affects affordability because this is part of household debt. Finally, Mr. Simpson pointed out that millennials are more apt to research, identify, establish, and maintain relationships with businesses based solely off of their web or online experiences. This impacts the way that financial institutions do business with millennials.

Thereafter the panel entertained questions such as how millennials use financial services, how they chose their bank (and what factors they use in choosing a bank) and whether the panel views their banking service needs changing rapidly or in a major way. The panel also discussed how they prefer to be communicated with by their financial institution and what factors they would consider in changing banks.

Member Williams and several other Committee Members commented that it appeared that the community banks have an edge in that they provide an individual service relationship that is unique and differentiates them from the larger, mega banks. Thereafter there was a general discussion concerning the questions and issues presented by the panel.

Chairman Gruenberg observed that the millennial panel all appeared to value technology and the ability to engage with an institution on a remote basis, as well as have real people at institutions they can call for assistance, if necessary. Chairman Gruenberg commented that he found this dichotomy interesting and encouraging, observing that smaller institutions can offer millennials basic services online as well as the value of having an actual contact at the bank.

The Committee stood in recess at 10:31 A.M. and reconvened at 10:45 A.M. that same day.

After the break, Ms. Ryan introduced the next panel discussion “Update on the FDIC’s Regulatory Review under the Economic Growth and Regulatory Paperwork Reduction Act (“EGRPRA”).” Ms. Ryan introduced Roberta McInerney, Deputy General Counsel in the Legal Division, and Ruth Amberg, Assistant General Counsel, in the Legal Division, who provided a general update on EGRPRA. Jim Watkins, Senior Deputy Director, RMS, and Bob Storch, Chief Accountant, provided a report on a number of initiatives currently under way.

Ms. McInerney began by mentioning that the EGRPRA statute requires the FDIC, OCC, and Federal Reserve to review regulations at least once every ten years. The purpose of the review, Ms. McInerney went onto explain, is to identify any outdated or unnecessary regulations that affect insured depository institutions. Ms. McInerney reported that the last EGRPRA review was in 2006 and that the current review is on target to be completed by the end of this year. Ms. McInerney went on to explain that the agencies began the EGRPRA review in 2014 by publishing the first in a series of four Federal Register notices that requested comments from bankers and other interested parties. The comment period for the fourth and final notice ended this past March. She stated that the four notices covered all regulations issued by the agencies through December 31, 2015, so as to allow comment on Dodd Frank regulations, as requested by bankers and others. Ms. McInerney explained that each regulation was organized according to 12 substantive categories, applications and reporting, powers and activities, international operations, banking operations, capital, Community Reinvestment Act, consumer protection, directors, officers, and employees, money laundering, rules of procedure, safety and soundness, and securities. Ms. McInerney noted that in addition to the Federal Register notices, the agencies held six outreach events across the country in the West, the East, in the middle of the country, and with over 1,000 participants attending in person, by telephone, or via live stream with the Kansas City outreach meeting specifically focused on rural and community bank issues.

Ms. McInerney then reported that the Agencies received over 250 written comment letters in response to the four (4) Federal Register notices. The Agencies are now in the process of analyzing the comments and plan to complete the final EGRPRA report by the end of this year and submit the report to Congress, as required under the statute. Ms. McInerney noted that the Agencies have already begun to take action in response to some of the comments received. Ms. McInerney then turned the discussion over to James Watkins to report on actions the FDIC has taken so far and is still in the process of taking, and also some of the comments received.

Mr. Watkins began by touching on some of the regulatory burden reducing initiatives and actions taken or in the process of being taken. He explained that the FDIC has so far issued several financial institution letters relating to the deposit insurance application process to aid applicants in developing proposals for federal deposit insurance, and to enhance transparency of the application process. Mr. Watkins pointed out that the FDIC previously released a financial institution letter relating to applications which have significantly streamlined the requirements for applications to conduct permissible activities for certain bank subsidiaries organized as Limited Liability Companies or LLCs.

Mr. Watkins next mentioned that the FDIC remains committed to working with groups interested in organizing community banks. To this end, Mr. Watkins explained, the FDIC is developing additional resource materials, as suggested by Director Doreen Eberley this morning, to guide applicants through the application process.

Lastly, Mr. Watkins mentioned that upon authorization provided under the FAST Act, the banking agencies moved quickly to make an 18-month examination cycle available to more community financial institutions by increasing the eligibility threshold for qualifying institutions from $500 million in total assets to $1 billion in total assets.

Mr. Watkins then turned the discussion over to FDIC Chief Accountant Robert Storch to discuss issues relating to call reports. Mr. Storch began by reporting that the FDIC and the other banking agencies are continuing to move forward with the FFIEC's Community Bank Call Report Burden Reduction Initiative. One action area in particular, he stated, that the agencies are in the final stage is the implementation of an initial number of burden reducing changes to the call report. He pointed out that these burden reducing changes were issued as part of a proposal in September of 2015 and after considering the comments and the proposal, the FFIEC and the banking agencies recently finalized these provisions. Mr. Storch also indicated that drafts of the revised reporting forms and instructions for these changes were posted on the FFIEC's website in early July. Mr. Storch mentioned that bankers offered suggestions for streamlining the call report. He pointed out that the constructive banker feedback about call report burden and these options from the task force's community banker outreach activities have helped the agencies develop a specific call report streamlining proposal for small institutions. Mr. Storch explained that this proposal is now being reviewed by senior leadership of the FFIEC's member entities. Mr. Storch reported that the FFIEC and the agencies anticipate publishing this proposal within the coming months and believe it should meaningfully expand the burden reducing changes to the call report well beyond those included in the September 2015 proposal.

The panel then took brief comments from the Committee.

Ms. Ryan then introduced the panelists for "Update on Consumer Compliance Issues," Jonathan Miller, Deputy Director, DCP, Luke Brown, Associate Director, DCP, and Faye Murphy, Section Chief, DCP.

Mr. Miller moderated the discussion and introduced Mr. Brown and Ms. Murphy to present on the new compliance ratings proposal.

Mr. Brown began the presentation by reporting that on May 3, 2016, the member agencies of the FFIEC released a proposal for updating the interagency Consumer Compliance Rating System. He explained that the rating system is used by examiners to evaluate financial institutions' adherence to consumer compliance laws and regulations, the main purpose of the rating system is to ensure that institutions are evaluated by the FFIEC agencies in a comprehensive and consistent manner. Mr. Brown went on to explain that the goal is to ensure that supervisory resources are appropriately focused on areas that exhibit risk and on institutions that warrant elevated supervisory attention.

Ms. Murphy then provided a summary of the proposal. She explained that the proposal retains the current five scale framework for the Consumer Compliance Rating System. She went on to explain that the proposed rating system reflects risk based expectations commensurate with the size, complexity, and risk profile of institutions and provides incentives for institutions to prevent, self-identify, and address compliance issues. Ms. Murphy stated, each institution would be assigned a consumer compliance rating based primarily on the adequacy of its compliance management system which is designed to ensure compliance on a continuing basis. Ms. Murphy stated that the agencies are proposing a rating system that includes three categories of assessment factors, board and management oversight, compliance program, and violations of laws and consumer harm.

Ms. Murphy explained that when assigning a rating under the proposed rating system, the examiners will consider each of the assessment factors in each category; there are a total of 12. She went on to explain that the three categories allow examiners to distinguish between varying levels of supervisory concern when rating institutions for compliance with federal consumer protection laws. Ms. Murphy then mentioned that the consumer compliance rating is intended to reflect a comprehensive evaluation of the institution's performance. It is not based on a numeric average or any other quantitative calculation. Specific numeric ratings will not be assigned to any of the twelve assessment factors.

It is important to stress that all institutions, regardless of size, should maintain an effective CMS. The sophistication and formality of the CMS typically will increase commensurate with the size, complexity, and risk profile of the entity. It is also important to note that the articulation of CMS assessment factors is not intended to create new expectations for lower risk institutions. Ms. Murphy next described the rating system categories and the assessment factors. She explained that the first category of the proposed rating system, board and management oversight will be used to analyze the institution's CMS and the role of its board and management officials. The four assessment factors in this category would be oversight and commitment, which will measure the institution's compliance risk management program; change management which will measure the effectiveness of the institution's change management processes, including responding timely and satisfactorily to any variety of change, internal or external, to the institution; comprehension, identification and management of risk that arises from the institution's products, services, or activities and corrective action and self-identification which considers any corrective action undertaken as consumer compliance issues are identified. She reminded the Committee that Compliance expectations contained within this category extends to third-party relationships into which the financial institution has entered. Examiners should evaluate activities conducted through third-party relationships as though the activities were performed by the institution itself. She also reminded the Committee that the Agencies believe the above factors would provide examiners with an effective and consistent framework for evaluating whether or not board and management are engaged to a satisfactory degree at a particular institution. All institutions, regardless of size, should maintain an effective CMS. However, each institution should be evaluated based on its size, complexity and risk profile and that

Ms. Murphy explained that the second category, compliance program, would be used to analyze other elements of an effective CMS. Ms. Murphy stated that the assessment factors for a compliance program are whether the policies and procedures are appropriate to the risk in the products, services, and activities of the institution; next is training which is where the degree to which compliance training is current and tailored to risk and staff responsibilities is evaluated; the next factor is to evaluate the institution's sufficiency of monitoring and/or audit; finally, Ms. Murphy discussed consumer complaint response where the responsiveness and effectiveness of the consumer complaint resolution process is evaluated. Additionally, Ms. Murphy added, examiners review a financial institution's management of third party relationships and services as part of its overall compliance program. In addition, Ms. Murphy indicated that the Agencies believe these factors, along with Board and Management Oversight would provide an effective and consistent framework to evaluate an institution's CMS. Each of these assessment factors would be considered in evaluating risk and assigning a consumer compliance rating. As explained above, each institution would be evaluated based on its size, complexity and risk profile.

Ms. Murphy next discussed the third category, violations of law and consumer harm. This, Ms. Murphy added, will provide examiners with a framework for considering the broad range of violations of consumer protection laws and evidence of consumer harm. Ms. Murphy pointed out that consumer harm may occur as a result of a violation of law; and while many instances of consumer harm can be quantified as a dollar amount associated with financial loss, such as charging higher fees for a product than was initially disclosed, consumer harm may also result from a denial of an opportunity. In this way, Ms. Murphy stated, in conjunction with assessing an institution's CMS, based on the first two categories, examiners will evaluate the consumer protection violations, if any, and related consumer harm, based on the following four assessment factors; The root cause assessment factor analyzes the degree to which weaknesses in the CMS gave rise to the violations, the severity assessment factor weighs the type of consumer harm, if any, that resulted from violations of law, the duration assessment factor describes the length of time over which violations occurred, and the pervasiveness assessment factor evaluates the extent of the violations and resulting consumer harm, if any. Ms. Murphy indicated that examiners are directed to consider all violations of consumer law, based on the root cause severity, duration and pervasiveness of the violation. In this way, Ms. Murphy said, the approach emphasizes the importance of a range of consumer protection laws and is intended to reflect a broad array of risks in the market and the potential harm caused by consumer protection related violations.

Mr. Miller then opened the panel up to comments and questions from the Committee.

Member Bryant asked for clarification regarding self-identification; he asked when there is a safety and soundness examination, would the examiners be able to look at the Board minutes for compliance issues and that it was properly identified and corrective action taken? Mr. Brown responded by stating that there are a number of ways compliance issues can be identified whether through monitoring or audit, if an issue is identified and resolved, that is something that the examiners would like to see when they come in for a formal examination. Mr. Brown went on to state that there is no express mention of self-identification in the current rating system, so the idea was to include it in the proposal so that banks could receive credit when they self-identify appropriately. Mr. Miller added that active participation and oversight of the Board is included in the new rating system and pointed to the chart on page 24 of the proposal.

Member Williams asked for clarification on the component ratings and the overall ratings. Mr. Brown clarified that the new rating system has an overall rating, but the examiners will still consistently think through the 12 components.

Member Haskin commented that there have been waves and waves of new consumer regulations put upon the banks and some have not had very large windows to train and educate, and even to acquire software to be prepared. In this instance, Mrs. Haskin stated that she hoped that the examiners would be mindful of the time involved to train and educate on the new regulations, especially the mortgage rules. Members Williams and Blankenship also voiced concern on this issue. Mr. Miller responded that examiners would look for efforts by the banks to actively get into compliance,

Member Haskin commented that the reference material for lenders to use is complicated and not user friendly. Mr. Miller responded by stating that this is a helpful comment and that it would be passed along.

Member Lundy suggested that a common road map be developed that takes into account the various States have differing laws concerning joint property ownership.

Mr. Miller then provided a summary update of developments regarding the Community Reinvestment Act (CRA). He indicated that last week the FDIC released a second set of CRA questions and answers which provide additional guidance in a number of areas including availability and effectiveness of retail banking services and innovative and flexible lending practices. Two areas in particular that Mr. Miller pointed out are a bank's investment in broadband infrastructure, (the whole community including low and moderate income segments) and energy efficiency. In this way, Mr. Miller commented, if it is a small community and the bank is providing access to the whole community, then the bank would receive credit.

The Committee stood in recess at 11:40 A.M. and reconvened at 1:09 P.M. that same day.

After the break, Ms. Ryan introduced Doreen Eberley, Director, RMS, James Watkins, Senior Deputy Director, RMS, Rae-Ann Miller, Associate Director, RMS, Mark Pearce, Director, DCP, and Jonathan Miller, Deputy Director, DCP, to give a presentation entitled "Fintech Developments."

Mr. Watkins began the discussion by indicating that the FDIC has formed a Fintech Steering Committee ("FSC") comprised of FDIC executives from supervision, as well as the insurance and research areas. It also includes representation from our Office of Corporate Risk Management and the Legal Division. Basically, Mr. Watkins explained, the purpose of the Committee is to gain an understanding and monitor fintech activities, developments, and trends, evaluate the impact on stakeholders, banking, and the deposit insurance structure which includes supervision, oversight, economic inclusion, and consumer protection. Mr. Watkins also noted that the FDIC has internal working groups that are actively researching and gaining an understanding and insights into the fintech area related to banking. Mr. Watkins then turned the program over to Ms. Miller.

Ms. Miller began her presentation by quoting the definition of the term "fintech" from the Financial Stability Oversight Council as "the use of technology in an attempt to make financial services more efficient." Ms. Miller explained that in some respects, fintech is viewed as having the potential to expand existing financial services and in other respects fintech is attempting to improve efficiencies in the back office space. Ms. Miller then went on to expand on the dimensions of fintech. In this regard, she explained, there are fintech companies and processes that develop credit products related to marketplace lending, there are companies that specialize in offering deposit accounts without brick and mortar, there are companies, mostly partnering with banks, at this point, that just offer deposit-gathering services. Then Ms. Miller explained that within the payment sphere, there are a number of person-to-person payment systems, international payment transfer and currency exchanges and in terms of investment management and personal finance, there are companies and applications that aggregate accounts. Ms. Miller further explained that there are investment allocation packages and high frequency trading. Then the back office processing covers things like distributed ledger technology and smart contracts. She said that under capital markets, we look at companies and services that facilitate, trading, settlement and even security valuation services.

Ms. Miller then explained the basic benefit of fintech which essentially is that technological innovation tends to promise speed, cost reduction and a better customer experience. Additionally, Ms. Miller added that fintech can increase access to the banking system with deposit and credit products.

Ms. Miller then turned the program over to Jonathan Miller.

Mr. Miller began by discussing some of the challenges and risks posed by fintech. He explained that when banks enter into any new product, service or third party relationship, whether fintech or any other area, they need to identify and understand the associated risks and then manage and mitigate those risks. In this way, depending on the activities and business model of the fintech company, Mr. Miller explained, risks presented by fintech are similar to those faced by banks but there may be heightened risks. Mr. Miller provided an example of a technology-focused service, there will be cyber issues, and in the IT area, reliance on the technology may be a particular risk to be aware of. Mr. Miller also indicated that since some of the firms rely very heavily on sophisticated models, such as underwriting models, and they so far have been untested under stress conditions, they may, if not properly monitored, pose fair lending risk.

Other challenges, Mr. Miller explained, include disintermediation, or disruption, as he called it, of traditional banks and their service providers and changes in capital markets processing, given market breadth and the size and number of the participants that could be affected.

Mr. Miller next mentioned ongoing efforts by the FDIC to follow the developments in fintech. In this regard, Mr. Miller discussed FDIC steering groups including two interdivisional working groups, split between wholesale and the retail aspects of fintech.
The wholesale aspect focuses on repos, derivatives, clearing, central counterparties and credit; monitors distributed ledger technology, smart contracts, as well as the development of virtual and alternative currencies. The retail group focuses on consumer and small business aspects of fintech, follows trends in marketplace lending; alternative scoring systems and mobile and virtual deposit services, account aggregators and person-to-person payments.

Mr. Miller also mentioned that the FDIC has frequent interactions with interested stakeholders, for example companies that offer fintech products and services, and attend and participate in conferences. These meetings, Mr. Miller reported, are an important source of information.

Mr. Miller next discussed the various ways, on an ongoing basis that the FDIC monitors and responds to innovation. One of the principal areas the FDIC has been working on is increasing access to mainstream financial services and much of this involves technological innovation. Mr. Miller pointed to the work done through the Advisory Committee on Economic Inclusion or ComE-IN. The focus, Mr. Miller explained, is on the use of mobile financial technology to increase access. Mr. Miller also mentioned the Alliance for Economic Inclusion and Bank-On movement as another effort to involve the unbanked and underbanked into mainstream financial services and the use of technology to achieve that goal. Finally, Mr. Miller pointed out that the FDIC monitors and addresses issues related to fintech through the examination process. Mr. Miller then concluded the presentation and welcomed questions and comments from the Committee.

Member Seleski asked whether there has been thought about non-bank entities entering and eroding community bank's traditional profit areas.

Mr. Pearce responded by stating that the FDIC has been monitoring that issue and has seen some non-bank fintech companies coming in and attempting to disrupt what has been a traditional banking process such as remittance or wire transfers. Mr. Pearce did agree that this does pose a risk of putting pressure on revenue at certain banks that are relying on those services.

Member Blankenship mentioned the importance of focusing on the end liability of community banks; in this way, payments and the way money is transferred around, eventually it will end up at a bank. In this regard, she mentioned that the end liability of banks is something that the Committee should look at.

Member Haskin pointed out the area of online accounting is a challenging one for banks that are regulated and it would be helpful if there were clear definitions on how a bank can go about those processes within the regulations. He mentioned that it would be helpful for community banks and their regulators to work together to establish a clear method and requested the FDIC explore this issue more.

Member Castillo made the observation that managing third party technology risk will continue to be a large issue going forward. Mr. Pearce responded by pointing to FDIC guidance on third party relationships and the management factors and despite the evolution of technology, the principles in this guidance still remain; risk appetite, and performing due diligence of the firm and the monitoring of the firm and the structure of contracts to be effective in managing that risk. This, Mr. Pearce explained, remains consistent with long standing FDIC guidance. Member Castillo mentioned that he felt the guidance is really excellent.

Chairman Gruenberg then asked each member of the Committee if they could comment on the extent to which their institution is committed to fintech and provide a spectrum of concerns and/or benefits to fintech.

Member Tolomer commented that his institution had a full array of electronic services; online banking, business online banking, consumer online banking and mobile. So, he reported that his institution is offering pretty much what all the banks are offering, large and small, to small and medium sized businesses and the consumer. In terms of concerns, Member Tolomer was not concerned with third party lending. In terms of payment systems, Member Tolomer continued, it would be important to remain true to the particular banking model and continue doing what you're doing and recognize that there's plenty of competition every which way, whether it's a traditional bank or it's one of these fintechs.

Member Scully commented that the payment system front end worries her the most from a competitive standpoint. She also commented that her bank is investigating online accounting and feels optimistic about opportunities in internal processing. Member Scully indicated that her bank has a task force of loan officers looking into fintech with the purpose of monitoring risk.

Member Lundy mentioned that the most effective tool his bank uses is deposit capture and they are going through a core processor of conversion now. He commented as to risks and that his bank spends significant time with BSA and the compliance risks.

Member Castillo mentioned that his bank has most if not all of the fintech services used by the other banks represented on the Committee and that they were of great benefit to his institution over the last ten years. On the concern side, Member Castillo mentioned that the biggest challenge -- whether on the loan side or the deposit side -- is trying to eliminate some of the friction points that Member Haskin earlier spoke about. So, Member Castillo indicated that one of the biggest challenges is making that experience online close to (or as good as it is) when they talk to the person.

Member Williams agreed with Member Castillo and the comments made by the other Committee members. He felt P2P is going to get bigger. On the deposit side, Member Williams stated that his bank has the technology to be competitive.

Member Haskin mentioned in relation to her bank's technology framework, her bank keeps two areas of focus, mobile and real time payments. Member Haskin also mentioned that the use of technology has shrunk her bank's employee base, so that her bank, when it was half the size it is now, had over 100 employees; currently the bank is twice the size, and has 37 full time employees. This, Member Haskin pointed out, demonstrates the impact of technology on banking. Member Haskin mentioned that her bank is also struggling with the "friction points" mentioned by the other Committee members, but reminded that any bank is only going to be as good as its core processor and their technology. In this regard, Member Haskin pointed out that because there are four and five year contracts it requires planning four and five years into the future to know exactly how the bank is going to get to the end goal. Member Haskin also mentioned that she felt real time is going to be important to millennials.

Member Williams indicated agreement with the comments made by the previous Committee members. He mentioned that one of his bank's bigger concerns was a general lessening of the amount of non-interest income that could be brought in. For example, Member Williams explained, that his bank has a secondary market in mortgage loans which customers are now more apt to go online to get those. Member Williams stated that his bank moved into a new line of business (credit cards) to offset the revenue loss that will come due to technology changes.

Member Bryant mentioned that his bank is different in that they do not offer transaction accounts. Member Bryant stated, in the last couple years, has his bank started offering online banking. Member Bryant indicated that his bank also looked at acquiring institutions that will give access to transaction accounts. That being said, Member Bryant did say that he would be exploring ways that he could grow his institution, by looking at non- traditional sources.

Member Blankenship stated that her bank offers most of the fintech services that are readily available, but clarified that her bank is in a metropolitan area. She indicated that the bank has found that there is not any one sector of the population that is more accepting of new technology. Member Blankenship mentioned that with technology, the biggest question is risk versus reward; where is the bank's risk tolerance, and how much of that is the bank going to be forced into taking to stay relevant in the market? Other areas of concern involve the use of social media and marketing.

Member Thompson mentioned that her bank fairly offers all the same products as the other members of the Committee. The big challenge for her bank, Member Thompson said, is whether there is enough monitoring going on. So despite cutting down the number of available employees, the bank still is expected to monitor and measure whatever it is that the bank is putting out there, not only for regulatory purposes, but for internal purposes as well.

Member Emmons finished up the roundtable by indicating that he generally agreed with the comments made by the other Committee members. He went on to point out that all of those deposits and transactions bypass the banking system, and the banking community is left with a real strategic challenge. Member Emmons opined that in the current environment, community banks need to make sure that they are on top of all of the changes that are coming technology wise. What is concerning, Member Emmons went on, is the pace of change and the fact that change is coming quickly and there are going to be many options in the P2P space. He explained that the challenge will come from the pressure on the bank to stay on top of the payment system model that the customers want in the face of rapidly changing and evolving technology. He added that another area of technology development is business to business or the commercial side of the banking business. Member Emmons pointed out that cash management systems and the way a bank delivers services and the treasury functions with the businesses still can be customized, still can be priced, and still makes a difference. In this way, Member Emmons explained, the bank can build relationships on the business to business side of payments, and it becomes very similar to what is currently happening on the retail side (person to person).

Chairman Gruenberg then thanked the Committee members for their input and suggestions.

Ms. Ryan then introduced the next panel "Recent Supervisory Developments." Joining Director Eberley and Associate Director Miller are Deputy Director Mark Moylan and Chief Accountant Robert Storch. The focus of this panel, Ms. Ryan explained, is on recent supervisory developments, including a new work program for examiners called InTREx, and FASB's new CECL accounting standard.

Ms. Eberley began by introducing Mark Moylan to discuss the FDIC's new IT examination program, InTrex.

Mr. Moylan began by introducing the InTrREx program. He explained, the InTREx or Information Technology Risk Examination Program, is an enhancement of the existing FDIC IT examination work program. Mr. Moylan stated that the regulatory requirements surrounding a bank establishing an appropriate information security program are nothing new; however, the parameters set forth have lacked the recognition of cyber risk. Mr. Moylan explained that nTREx now specifically recognizes the emergence of the cyber risk element and better aligns and defines regulatory expectations in the assessment of a bank's information security program and the identification and mitigation of this new risk. He went on to explain that InTREx introduces three areas of change, pre examination procedures, changes to the format and structure of the examination work program, and new examination findings procedures; all of these changes are made to affect better risk scoping, enhance the examination process, and increase transparency, as well as board awareness.

First, Mr. Moylan discussed the pre exam procedural changes. The IT questionnaire has been replaced by the IT profile document which has 65 percent fewer questions for bank officials to answer and is better focused. Bank officials will now receive the document and have approximately two weeks to complete and submit it to the FDIC. Mr. Moylan explained that the two week preparation time, along with more effective questions, will provide the examiners with better information to risk focus the examination and appropriately staff the examination commensurate with the risk profile of the institution.

Next Mr. Moylan discussed the work program and went through the module with the Committee. Mr. Moylan explained that the module represents the framework that the examiners will go through; in this way, the work program modules now directly correspond to each of the Uniform Rating Systems for Information Technology (“URSIT ratings”), and provides examination staff with specific decision factors and analysis procedures, including basic and expanded procedures. Mr. Moylan indicated that the new program will provide better examiner guidance, a more consistent examination approach, and better support for the conclusions drawn. One of the other points, Mr. Moylan stated, was that the new program provides better transparency in that it discloses the entire URSIT rating. Historically, Mr. Moylan explained, the FDIC has only been disclosing the IT composite rating, going forward the FDIC will now be disclosing all of the components. This, Mr. Moylan explained, will allow the bank board to better understand and be more attuned to the recommendations.

Mr. Moylan next explained that the ECC page will still give a summary comment regarding the IT overall examination findings but there will now be an information technology assessment page and this is mandatory. This page, Mr. Moylan explained, will have a discussion of each of the components and the rating and also a summary comment on the bank’s cybersecurity preparedness. Mr. Moylan indicated that this will provide transparency of not only he components, but also the examiner opinion of the bank’s cyber preparedness.

Mr. Moylan also welcomed feedback on how the program works going forward.

Ms. Miller then reported that on June 30th her group issued a FIL on an updated set of brokered deposit Frequently Asked Questions (“FAQs”). Ms. Miller indicated that the FDIC originally issued the broker deposit FAQs in January of 2015 with the intention of providing plain language information about categorizing brokered deposits all in one place. The FAQs, she explained, are based on the statute and on a regulation, but also on explanations of the requirements that the FDIC provided to the industry through advisory opinions from time to time.

Ms. Miller next mentioned that pursuant to Section 956 of the Dodd Frank Act, the FDIC issued a notice of proposed rulemaking (NPR) on April 26th regarding incentive compensation. Ms. Miller explained that Section 956 requires six agencies (the FDIC, OCC, Federal Reserve, NCUA, SEC and FHFA) to jointly prescribe either guidance or rules that prohibit any type of incentive-based compensation arrangements or any feature of those arrangements that the agencies determine encourage inappropriate risks by a covered financial institution. She went on to explain that Section 956 requires that financial institutions disclose to the appropriate Federal regulator the structure of incentive-based compensation arrangements sufficient to determine whether that structure provides excessive compensation that could lead to material loss to the institution. Ms. Miller stated that Section 956 applies to incentive-based compensation arrangements offered by covered financial institutions, which are defined as insured depository institutions, depository institution holding companies, credit unions, broker dealers, investment advisors, Fannie Mae, Freddie Mac, and other institutions that the agencies jointly determine should be covered by the rule. She went on to explain that within those covered companies, those over $1 billion are covered and thus any institutions that are less than $1 billion are exempt from the rule. Further, she explained, the NPR uses a tiered approach with respect to its requirements, so Level 1 are institutions $250 billion or more; Level 2 is $50 billion to $250 billion, and Level 3 is $1 billion to $50 billion. Ms. Miller stated that all covered institutions would be subject to a set of basically programmatic elements, policies, procedures, and recordkeeping type of requirements; then as the institutions get larger they would be subject to more stringent provisions.

Member Scully asked whether the NPR could be restructured to make it easier to understand for those banks that are at Level 3. Member Scully explained that due to the length of the NPR (some 600 pages) it was challenging to locate the sections that applied to the Level 3 banks.

Ms. Miller indicated that the FDIC would take that into consideration. She reminded the Committee that the FDIC is currently taking comments as it moves through the process.

Mr. Storch then provided an update on activity at the Financial Accounting Standards Board ("FASB"). Recently, Mr. Storch reported, FASB issued an Accounting Standards Update ("ASU"), on the measurement of credit losses on financial instruments, which represents several years' work by the FASB to improve the accounting for credit losses. The ASU, Mr. Storch explained, formally introduces the Current Expected Credit Losses ("CECL") methodology for estimating allowances for credit losses and will replace today's incurred loss methodology when the new standard takes effect. Mr. Storch stated that the new standard can be downloaded from the FASB's website.

Mr. Storch explained that the allowance for credit losses under CECL is a valuation account measured as the difference between the amortized cost basis of financial assets and the net amount you actually expect to collect on those assets. In other words, he said, the allowance is an estimate of lifetime credit losses for however long those assets will remain on the bank's balance sheet. Further, Mr. Storch explained, the CECL methodology applies to all financial assets carried at amortized cost, including loans or investments, traditional loan portfolios, held to maturity securities, off balance sheet exposure such as loan commitments, and standby letters of credit. He added that the new CECL standard also updates the measurement of credit losses for available-for-sale debt securities. Mr. Storch stated that to estimate expected credit losses under the CECL methodology, institutions will use a broader range of data than other existing generally accepted accounting principles, or GAAP accounting; including information about past events, current conditions, and reasonable and supportable forecasts relevant to assessing collectability of cash flows on financial assets. In contrast, Mr. Storch explained, under today's incurred loss methodology, only past events and current conditions can be considered when estimating credit losses.

Mr. Storch then set forth some differences between today's incurred loss methodology and the coming CECL methodology. He explained that the FASB strived to ensure that the new accounting standard will be scalable to institutions of all sizes and does not expect smaller and less complex institutions will need to implement costly and complex modeling techniques. Further, Mr. Storch explained, institutions should be able to modify their existing allowance methodologies to meet the newer accounting standards; in so doing, institutions will, however, need to change certain of the inputs and assumptions they use to achieve an estimate of lifetime credit losses. Mr. Storch stated that acceptable estimation methods under the CECL methodology that are identified in the standard include loss rate methods, world rate and migration methods, discounting cash flows, probability of default and loss given default methods and the new standard explicitly states that institutions are not required to use a discounted cash flow methodology to estimate expected credit losses. Mr. Storch explained that because the ASU doesn't specify a single method for measuring expected credit losses, the standard allows institutions to use judgment to determine the relevant information and estimation methods that are appropriate in their individual circumstances; in addition, an institution may apply different estimation methods to different groups of financial assets.

Mr. Storch reported that FASB has provided significant lead time for institutions to prepare for their implementation of the CECL methodology until the new accounting standard takes effect and at the same time they provided the agencies with significant lead time to prepare. Mr. Storch explained that for those institutions that, for accounting purposes, are deemed SEC filers, the new standard will take effect in 2020. All other institutions will begin reporting under the CECL methodology either in their first quarter of 2021, or as they end fiscal '21, depending on an institution's characteristics.

Mr. Storch advised that in the joint statement, the agencies encouraged institutions to start their planning and preparation for the new accounting standard now, including becoming familiar with the new standard. In this regard, Mr. Storch recommended that bank directors begin now obtaining a basic understanding of the new standard, since it will change the metrics the bank looks at. Finally, Mr. Storch stated that both during and after the transition to the CECL methodology, the FDIC's goal is to ensure consistent and timely communication to institutions about the new standard and to develop and issue updated supervisory guidance pertaining to the standard, particularly with respect to smaller and less complex institutions.

Mr. Storch then opened the discussion up to questions and comments from the Committee.

Member Williams asked about the FDIC's role moving forward toward implementation. Mr. Storch responded that FDIC accounting policy staff have been discussing what sort of expectations examiners should have and that these questions are on the list of what the FDIC would expect to be communicating to banks. He suggested that it might be advisable for banks to perform some dry runs in advance of when implementation finally takes effect and noted that the FDIC will have a good level of examiner preparation so they understand, as well.

Member Castillo asked whether FASB or the FDIC has modeled what they think an allowance might look like under the CECL method.

Mr. Storch responded that there has been some modeling to assess what the potential impact would be. Mr. Storch went on to explain several different scenarios relating to modeling loss allowances.

Member Lundy made an observation that there has been significant margin pressure over the last five years and bankers and regulators, based on (his bank's) historical experience, have been rightly concerned about interest rate risk.

There was then a discussion among Committee members and the Panel concerning some of the specific points of application concerning the CECL method.

Chairman Gruenberg then thanked the Committee members in general and specifically thanked those Committee members who were leaving due to the expiration of their terms.

There being no further business, the meeting was adjourned at 2:49 p.m.

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

Minutes

of the

Meeting of the FDIC Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

July 20, 2016 – 9:00 A.M.

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

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