FEDERAL DEPOSIT INSURANCE CORPORATION

+ + + + +

ADVISORY COMMITTEE ON COMMUNITY BANKING

+ + + + +

MEETING

+ + + + +

WEDNESDAY,
NOVEMBER 3, 2016

+ + + + +

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

PRESENT:

MARTIN J. GRUENBERG, Chairman, FDIC
RICHARD T. BEARD, President & CEO, People's Utah Bancorp, American Fork, Utah
ADRIANA M. BOEKA, President & CEO, Americas United Bank, Glendale, California
ROGER BUSSE, President & CEO, Pacific Continental Bank, Eugene, Oregon
ASIF DAKRI, Vice Chairman & CEO, Wallis State Bank, Houston, Texas
CHRISTOPHER W. EMMONS, President & CEO, Gorham Savings Bank, Gorham, Maine
DAVID J. HANRAHAN SR., President & CEO, Capital Bank of New Jersey, Vineland, New Jersey
JACK A. HARTINGS, President & CEO, The Peoples Bank Corp., Coldwater, Ohio
CHANDLER J. HOWARD, President & CEO, Liberty Bank, Middletown, Connecticut

DANNY J. KELLY, President & CEO, The Hometown Bank of Alabama, Oneonta, Alabama
ARVIND A. MENON, President & CEO, Meadows Bank, Las Vegas, Nevada
TIFFANY BAER PAINE, President & CEO, Security Bank USA, Bemidji, Minnesota
MARY ANN SCULLY, Chairman, President, & CEO, Howard Bank, Ellicott City, Maryland
GWEN M. THOMPSON, President & CEO, Clover Community Bank, Clover, South Carolina
JOHN M. TOLOMER, President & CEO, The Westchester Bank, White Plains, New York
JOSEPH W. TURNER, President & CEO, Great Southern Bank, Springfield, Missouri

CONTENTS

CONTENTS

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

(9:00 a.m.)

CHAIRMAN GRUENBERG: I would like now to call this meeting to order. We will begin by thanking you all for being here. I confess I came to the reception last night a bit late, and everybody had left in order to get back to watch the ball game. I actually stayed up and watched the game to the end last night. I'm a little bleary-eyed, but it was worth it. It was really pretty remarkable.

I'm looking forward to today, I think it's a good agenda. And I wanted to get started on time and, briefly, recap. But, before I do, I'd like to, we have a number of new members of the committee joining us for the first time today. So, in particular, I'd like to welcome if I may quickly acknowledge them.

Richard Beard, the president and CEO of People's Utah Bancorp in American Fork, Utah. Adriana Boeka, the president and CEO of America United Bank in Glendale, California. I'm taking a chance with the pronunciation with a couple of these names. Asif Dakri, the vice chairman and CEO of Wallis State Bank, Houston, Texas. David Hanrahan, president and CEO of Capital Bank of New Jersey in Vineland, New Jersey. Chandler Howard, president and CEO of Liberty Bank in Middletown, Connecticut. Danny Kelly, president and CEO of Hometown Bank of Alabama in Oneonta, Alabama, and Tiffany Baer Paine, president and CEO of Security Bank in Bemidji, Minnesota.

Joseph Turner, president and CEO of Great Southern Bank of Springfield, Missouri. Welcome.

This committee has really been, if I may say, fortunate in the quality of membership we've been able to attract. And it's really been, from our standpoint, a very great value to the FDIC.

Now I'm going to give you a brief overview of today's agenda. In the initial session this morning, he will give us a brief update on the FDIC's community banking initiative. Doreen Eberley the director of our Division of Risk

Management Supervision, and Mark Pearce the Director of our Division of Depositor and Consumer Protection, Diane Ellis, who is the director of our Division of Insurance and Research, and Jared Fronk, a financial economist in our Insurance and Research Division will provide a brief update. We'll get right into the initiative.

Five senior staff in the Division of Risk Management Supervision will provide background on some outreach meetings that the FDIC had has recently posted to assist groups interested in forming de novo institutions. I know this has been a lot of particular interest. So far, the FDIC has hosted two outreach sessions, one in San Francisco and another in New York, and we're planning to host a third session in Atlanta later this month. And we are planning additional de novo outreach meetings in other parts of the country next year.

I should also mention that, last week, the FDIC hosted a roundtable discussion with representatives of colleges and universities, we actually hosted this down in our Dallas regional office, which represented leaders of colleges and universities that have undergraduate and graduate banking programs designed to train the next generation of community bankers.

There is room for collaboration between banks and academic institutions to educate and train. And this generation of community bankers will really want to pursue this and explore the potential for enhancing the relationships that the existing programs have with their banking communities and potentially identify institutions of higher education in other states and localities that might be interested in establishing programs like this to provide a source of support in development of young people with an interest in community banking.

Following a break at 10:30, we're going to have an update on the current status of the Deposit Insurance Fund, an FDIC assessment rate which we assume is of a matter of some interest to you. We actually have a little bit of good news in that regard, so in particular we don't want to miss the opportunity to share that with you.

And, after the session on assessments, we'll discuss some recent developments in consumer protection and compliance, and Mark Pearce will lead that discussion.

After the break for lunch, we'll have a discussion on recent developments in risk management supervision policy, including the recent issue on third-party lending guidance and interagency community bank call report proposal and an update on the regulatory review process being conducted pursuant to EGRPRA, the Economic Growth and Regulatory Paperwork Reduction Act.

And we'll conclude the day by -- we thought we would try this -- with an open roundtable for however community members to raise and discuss some of the issues on your mind that you might to resurface and raise with us and bring to our attention.

I should mention, just as a reminder, that this meeting is open to the public we are webcasting the meeting so keep that in mind when engage in our conversations during the course of the day. And, with that, I will turn the first session over to Barbara Ryan.

MS. RYAN: Thank you, Chairman Gruenberg, and good morning, everyone, and welcome to our new members.

So, as Chairman Gruenberg indicated, we have a full day today and a lot of interesting topics. We thought we would begin this morning by providing the committee with a quick update on some of the developments in our Community Banking Initiative.

First, Diane Ellis, director of our Division of Insurance and Research, and Jared Fronk, who is a financial economist in that division, are going to give a preview of a paper that has not yet been completed but that they are finalizing. And it's on core profitability at community banks.

And then, following that, Doreen Eberley, the director of our Division of Risk

Management Supervision, and Mark Pearce, director of our Division of Depositor and Consumer Protection, are going to update you on some of the other initiatives underway as part of the Community Bank Initiative.

So I'll turn it over to Diane and Jared.

MS. ELLIS: Thanks, Barbara. For those of you who are new members, I thought I might just start by explaining the role the Division of Insurance and Research has in our Community Bank Initiative. Over the last several years, conducting research on topics relevant to community banks has been one of our priorities that really started in 2012 with a pretty comprehensive study of community bank industry. And, since then, over the years, we've done sort of more focused research on particular topics of interest, all to sort of better understand the trends affecting community banks, some of the opportunities and challenges, and so forth.

So we have found that coming to this group, particularly before research has been released, is particularly helpful to us, to give you all a preliminary look at some of our research, get your feedback, questions, and so on. So I would encourage you to ask questions or -- and, if you have ideas for further research topics, we're sort of thinking about our agenda for 2017 right now. So we would be interested in your ideas, any questions you all might have.

So today, as Barbara said, I brought Jared Fronk with me. He's been doing some research on core profitability at community banks that we hope you find of interest. He's going to give you a really high level look at the research. There are some slides, I think, on the left-hand side of your -- yeah, it looks like this.

Again, it's very high level. Underlying his analysis is a lot of -- there's a technical model and so forth. Jared is not going to leave that out of his presentation but is capable of answering any questions you all might have. So, again, I'll turn it over to Jared now for a brief overview of his research.

MR. FRONK: Thanks, Diane. So we'll just jump right in. We've been looking at the core profitability of community banks, and we're looking at the time period from 1985 to 2015. We'd love to include 2016, but it takes about six to nine months' lag to get the data, so that won't be out for a long time.

The research question boils down to what is the state of the community banking profitability industry-wide community banks, their core profitability. And what we mean by that is, once we strip out all of the economic factors, all of the macroeconomic things that are happening to banks that they have no control over, how would they inherently do? What's their intrinsic ability to make profits?

So what that consists of, on the economic side, we're looking at four separate variables: state level unemployment, realizing that community banks are heavily involved in their communities, and that's where a lot of their action takes place. We're looking at state level GDP growth, or GSP growth. We're looking at the spread, and we're looking at interest rates.

So those are the macroeconomic factors we're trying to analyze. We're going to strip them away from profitability in the industry and get a look at what's left over, which we're going to core profitability or structural profitability.

Now we don't analyze what that consists of. That's going to be, basically, what's left over after you get rid of all of the other things. So that would consist of things like regulation, business practices, loan composition, portfolios, entry and exit, non-bank competitors. All of those factors are all going to be lumped in together into what's left over. Does that make sense?

All right. So let's start with this first slide, this first slide with a graph on it. What you're looking at is pretax ROA. We're decomposing it into those four economic shocks. And a shock is something -- a difference from a norm. So, if you have a really productive year with high economic growth, that's a positive shock.

If you have, for instance, a crazy recession in 2008-2009, that's a negative shock.

We're going to look at unemployment rate, which you'll see is this dark blue, purplish color, the interest rate, which is the lighter blue color, the spread, which is gold, and gross state product growth, which is going to be this green. The solid black line is pretax ROA as an average of all community banks. And those shaded blue lines are recessions.

The things I want to point I want to point out here, first off is unemployment. You'll see it pretty much dominates the page. It is a big boost from the -- in the 1990s and early 2000s. And, once the recession hits, it becomes a huge drag. And I don't think anyone would be surprised to hear that.

One of the things that is a little surprising, though, is GSP growth seems to not matter that much. And probably the best reason is simply that, since growth of -- our economic growth is tied very closely to unemployment, or employment growth, unemployment is kind of swamping the other variable. So they're both important. Especially during the Great Recession, GDP growth was a big factor independent of unemployment but, separate from that, usually not a major deal.

The other interesting thing I want to point out is spread. You'll notice it kind of moves up and down all the time, as we've seen as the spread has flattened and steepened, or the EO curve has flattened and steepened over the years. The important part to point out here is that it seems to always come down just before the recession. So at least it's a good indicator of we're going into that.

I guess it's comforting seeing in 2015 it's still a very positive number so we're -- at least according to this, we shouldn't expect a recession any time soon, unless there's been a lot of talk of low for long as that being the major issue of interest rates. And you actually see that, for most of the time, the interest rate -- this light blue -- it's not a big deal until you get to the recession. And then the thickness of that light blue line gets bigger, and gets bigger over time. So the longer interest rates have been low, the more damage it's done.

Any questions on that?

MEMBER TOLOMER: Yeah.

MR. FRONK: Yes.

MEMBER TOLOMER: Well, why do you use pretax borrowing?

MR. FRONK: Some banks -- I'm trying to think. So I worked with -- you'll have to forgive me, I’ve only been working here a year, I don't know all the terminology yet. We're trying to make this the same for all the banks, 90 percent maybe.

MEMBER SCULLY: How do you define "spread"? Is it just the end or --

MR. FRONK: So the spread is the 10-year to 1-year treasury rate. I hear that it's also pretty common to use 10-year to 2-year. I'm going off of what the literature tends to do. I did check it with 10-year to 2-year, and there's no difference.

MEMBER HANRAHAN: So do we understand it's tracking recovery spreads being a positive contributor to ROA for the last six years, seven years?

MR. FRONK: Yeah. Effectively, it's a little surprising, but that's how it comes out in the map. So I think, basically, what's happening is, because interest rates are so low, any incremental change in that spread actually ends up being a very positive thing. Interest rates are a drag. Interest rates are the drag, but the spread itself is positive.

MEMBER HANRAHAN: I think things are going a little further on the EO curve and taking advantage of that as well.

MR. FRONK: All right. If you'll join me on the next slide, I will get down to results on core ROA. First off, headline, it's been averaging over this entire period about 98 basis points. So that is the -- if you just look at this 31-year period, the average core is 98. So that's on you strip out all of those economic effects, what you'll see here is this violet color. That's the net economic shock once you've put all of those economic shocks together.

The difference between this light blue line, which is the core ROA, and the solid black line, which is our observed community bank average pretax ROA, is just this violet bar. So all we did is strip out that economic shock. And then the dotted line is simply the average. If you assume that it has been a constant over this time, that's what you get. We tried to out different assumptions of trends and things like that. It's not a huge difference. It's actually pretty flat regardless of how you approach it.

So one of the interesting things to point out is how much of the variation from core ROA is due to economic factors. And so, when you look at it for the -- sorry, I'm losing my points. Everything is on this slide. Okay. There we go.

So, on the -- from 1985 to about 1990, economic factors do very little to change the deviation from core ROA, which stands to reason.

That was a crisis that was specific to the financial industry and not associated with an economic crisis in the wider economy.

From 1991 to the most recent crisis, economic factors actually explain about 76 percent of the variation in core -- or in observed ROA. And that was a very high period. Over that time, we had an average boost of about nine basis points. So you actually had a lot of economic factors coming in to boost -- observe profits and things.

And, since the most recent recession, economic factors explain about 80 percent of the variation. So we're saying that a large percentage of the observed profits that are seen are explained simply by the economy at large, and it's indifferent to anything that the individual bank could have been doing.

All right. Another thing to point out is the trend in core over these periods. So, in the very beginning, we get about a -- from 1985 to 1991, core is trending upward at about four basis points a year. From 1991 to 2007, it's trending downwards. The best explanation for that is simply, because those were economic high times, you didn't have to be a particularly profitable or efficient bank to make it.

So, as you had more and more banks joining who may have not been as efficient as they should have been, the average efficiency or profitability of the industry will be falling. So that's simply a compositional effect. Once you hit the Great Recession, a lot of those banks who are less profitable or higher risk were the ones who failed or dropped out or were purchased by other banks, which, on net, brought the average profitability of the industry back up.

So the core profitability of the industry has actually been rising since 2008 at a 5.5 basis point per year rate. So we're definitely on an upward trend, which is a good thing to hear.

The last thing I want to point out that you may have questions about, looking at this light blue line, is we seem to be going upward from 2008 up until about 2014 -- or 2013 when suddenly it jogs back down. You'll see that right here. My best explanation for that is, if you've heard of the -- people talk about the jobless recovery, and I think it's largely an artifact of the unemployment rate. We've had a lot of talk about how the headline unemployment rate may not be the best indicator of how the labor market is actually doing these days.

There's a lot of talk about participation rates and underemployment, so people who are technically employed but not making or doing the jobs that they would like to be doing. So I suspect that there's a serious issue where unemployment, even though it's come way down, isn't actually translating into as much increased wealth for our community banking customers as it typically had in previous periods. So that's showing up as -- this low unemployment as a big boost to be making profits in the economic model. I suspect, in reality, it's not nearly as big a boost as it's saying here.

So the last page, and then I'll answer any other questions you have. I just want to review these key conclusions, first off, over the entire course of the study, about half of the deviation or the variants in observed ROA can be explained by economic factors, which means that half of it is not explained by economic factors, things such as competition from non-bank actors, competition among community banks, entry and exit, regulation, all of those other things that go into it explain the other half of what's going on.

But, in this last period, it was only -- all right, 80 percent is covered by economic factors, so only about 20 percent remains to be explained by the structural changes.

The effects of the recession have been severe. They're the most severe of any group of years in this study, mostly not surprising, and they've been persistent. Core profitability was on the decline for most of this sample until you hit the recession, and those changes in how banks are operating in the composition of banks has actually led to a rise in the core profitability trend.

And that's it. Those are my points. Thanks. I guess any questions? Yes?

MEMBER HOWARD: Just one question. Were you able to look at mutual banks exclusive of the SOC institutions?

MR. FRONK: I don't think we have, but I can. It's very simple to do.

MEMBER HOWARD: It would be interesting to look at mutual bank performance as it relates to the other group of community banks because of the structure.

MR. FRONK: Thank you now --

MEMBER HARTINGS: Jared, did you also correlate the capital levels at banks, because you're using ROA to create that factor. Certainly capital is going to drive ROA up for a bank so, if you looked at a bank 30 years ago versus a community bank today. Did you correlate that at all?

MR. FRONK: So one of the things that we do, we use panel data, which allows me to include bank fixed effects which, as long as a bank's capital structure hasn't changed massively over its time. If it has, then that won't be accounted for. But, if it's consistent over years, any inherent characteristics of each bank that are not changing significantly over this 31-year period will be taken care of. So they will be netted out of the regression automatically.

So I'm not sure if that solves the problem right up or if it's something I need to control for in the future.

MEMBER HARTINGS: It would be interesting to lay your slides against the capital level at banks 30 years ago and currently because, again, that's going to drive ROA, the ROA ratio up at that point in time.

MS. ELLIS: So I think -- you're saying maybe do the same analysis but bucket it by banks and different capital -- different capital levels?

MEMBER HARTINGS: I think I'd just look at industry-wide first, and then you can, you know, decide if you want to look at individual, you know, subchapter S, mutuals, C corps. It would be interesting to see what our industry has done on a capital level, if -- I believe we have more robust capital. We have higher capital ratios. I mean, we've seen that.

But it would be interesting with your slide to see how that has a variance on ROA. So an ROA today at a higher capital level is different than an ROA 30 years ago, you know, 8 percent capital and 12 percent capital.

MEMBER HANRAHAN: I think ROA is -- it would be interesting to look at the data also. ROA is handy to look across banks. The FDIC has been rightly concerned about the declining number of banks in the country, and I believe that -- I mean, this is the point, is, if you hold ROA constant but you have to hold more capital, drives down ROA and that reduces return for stockholders and makes banks that are normally too upset. So it would be interesting to look at ROE.

MR. FRONK: Yeah. When we started this, we were doing quarterly data. As you might guess, that's really noisy data. And we looked at ROE, and it was just a mess, is what it boiled down to. But I haven't looked at it since we switched to the annual level data. So I'll take a look at that. Thank you.

MEMBER DAKRI: The point here where you said the profitability from 1990 to 2008 was declining, the trend shows it declining, and now we're showing the trend going back up. I think you had mentioned that part of the reason for the trend going up is the elimination of those banks that were not run as well as they should have been. Is there a way to segregate that and to say, you know, if we eliminate those banks from this equation, how much is this profitability actually rising?

I mean, we're just getting rid of the weakest link if you will. So, without balancing the equation from 1990 to 2008, is it flat-lined or what happens?

MR. FRONK: So one of the things that I did do as a robustness check was to look at the sample excluding banks that failed because I think that's fair to say, hey, we're all still in it. How are we doing?

First, you still get a rise. Overall, it's flatter. It's not the 5.5 basis point. I can't recall exactly what it is, but I can get back to you if you like. It still rises.

The other major result is, since you've excluded all of the banks that didn't do well and had low numbers, you end up getting much, much higher numbers. So, instead of having an average of .98, you can an average of like 1.2 something. Sorry, I can't remember the exact number. It's a much higher number.

So, if you exclude all of the banks that failed or were bought or purchased or, for various reasons, left the sample, of course, you get much higher numbers because you pick the winners ex post.

But we'll be happy to send you those results and let you know exactly what happened to everyone, I guess, the results of what happens if you look at only banks that are survivors in loss years.

MS. RYAN: Okay. All right. Well, I

guess we're back to Doreen and Mark.

MS. EBERLEY: Okay. Good morning, and I'll offer my welcome, extend my welcome to our new members as well. Happy to have you here. I'll give you a little bit of an overview of how the Division of Risk Management Supervision has approached the community bank initiative, and then I'll talk about the activities that we've conducted since the last meeting in July.

So our approach has been to make sure that we're carrying out our supervision program in a way that adds value to the industry and minimizes burden without sacrificing safety and soundness. So those are our overall goals. So we have, since 2012, taken a number of looks at various activities. We've focused on where can we streamline the examination process. One example there was really taking a hard look at our pre-examination requests lists and making sure that they were targeted to institutions. And we put in place a new system to help examiners make sure that the request lists were targeted.

We focused on transparency. An example there is making sure that we talked to the bankers after the exam about how we used the information we requested, and really having a conversation even before the exam to talk about how the information was used to risk focus the examination, and then how we used all of the information we requested before the examination.

And then a third area has been focused on providing technical assistance. We've got a technical assistance video program. It consists of director's college videos, which is a summary of the director's colleges that we deliver around the country every year.

We have targeted topical videos, so these are more in-depth videos that are designed for senior management, and really go in-depth on issues and interests. So the Bank Secrecy Act, interest rate risk, how to do evaluations and appraisals, when do you need one versus the other, topics like that. And then we also have our cyber challenge video series, which are videos that are designed for bank management to practice their response to actual kinds of cyber events that have occurred at institutions.

In addition to that, we have also focused on providing resources to institutions. We created our director's resource center on our web page. You can find that under the Community Bank Initiative. It also has its own link. And, on that page, you'll find all of the resources that we have developed the Community Bank Initiative. And on of the, I think, very hand things there is a listing of our financial institution letters sorted by topic. So, if you're curious if we've got guidance on a particular topic, you can go check there and see what's out there.

So that's a little overview of what we've been doing for the longer period of time. Specific to the last several months, we did mail out another resource, our Community Bank Resource Kit. If anybody didn't get one and wants one, let me know, and I'll bring some up at a break. But we mailed those out, Mark and I, finished that up around Labor Day.

We've gotten many requests for extra copies, and we've been honoring those and sending those out. And we've also been making copies available at our director's colleges, and they've proven very popular with the directors that attend those events in person.

And what we've decided to do to keep this current is that we have a lot of information, topical information, supervisory insight journal articles and other pamphlets on, you know, resources that we have available. As we add more articles that are of strong interest that we think should be part of the kit or new resources, we'll add those.

We'll do that about once a year. So, since we first put this together in April of last year, we'll be looking to update it again in April of next year and add more. We won't be taking content out, but adding some more content to it. So, if you have any feedback about things you think we should put in the kit, that would be great to hear from you.

In terms of technical assistance videos, we've established an executive steering committee to review our existing portfolio of videos on a regular basis and make sure that they're current. If there's anything we need to update, we want to make sure that we do that. And they're also advising Mark and I on content for new videos, so topics for new videos.

And that's another place where you can help us as well. So any ideas that you have about topics that we should be considering for next year, we're working on that right. The one topic that we have in the hopper already is managing concentrations. And so anything else that you think we should add we'd be happy to hear.

We also conducted a number of director's colleges since the last meeting. We had a number in April and September. And, again, we're in the planning process for next year for our core director's college modules. So, if there are specific topics that you think would be beneficial for us to add, that would be great to hear from you.

And we conducted a mutual bank forum on August 4th. We did that jointly with the OCC. That was a great day of discussion with mutual bankers about the ways that they are addressing the specific challenges that they face.

And then we have some follow-up activities to our community banking conference that we held in April. So, in addition to the couple that the chairman mentioned about the de novo roundtables and the meetings with the universities, those were ideas that flowed out of the conference in April.

We did issue a Supervisory Insights Journal article about the deposit insurance application process, and are working on a handbook for proposed organizers of de novo institutions, to guide them through the application process. And we are on target for issuing that for public comment before the end of the year.

So that's a quick wrap-up of the activities we've got going.

MR. PEARCE: And I'll pick it up from there. Good morning, everyone. As Doreen indicated, she kind of gave you the overview of our Community Bank Initiative over the last several years and communicated some of the updates that we've been making and how we're going to continue to make the different materials current and up-to-date. This really is sort of an evergreen initiative. It's not through take one thing and do it and then never come back to it. It's something that we want to keep refreshing. And, in that spirit, I want to update you on a couple of things specific to the Division of Depositor and Consumer Protection.

The first of those relates to our pre-exam planning process. As Doreen mentioned in her review, both on the risk management side and on the consumer protection side, we took a look at our pre-exam planning process two or three years ago to really look at opportunities to make that process more efficient and effective while not altering our supervisory standards.

And so, for the consumer compliance piece of that, what we really were able to do is improve our risk focus and do more data collection offsite at the beginning of the examination process, so that, when our examiners arrived at the bank for the onsite portion, they would have a deeper knowledge of the individual bank, and that would really help us risk-focus our examination and be more efficient and onsite.

Since we've implemented that change or enhanced -- we've always done pre-exam planning and tried to do that, but we've really built a structure to do a little bit more of that at the front end than we had been in the past. We've gotten really positive feedback from bankers regarding the improvements and enhancements we made in that process, in particular the sense that, when examiners arrive onsite, they really do have a deeper understanding of the bank and the different products and programs that are offered, and that the onsite portion has gone more efficiently and effectively as the examiners have had a greater handle on the risk at the very beginning of the examination.

The one piece of feedback we've gotten from some bankers is that, in the shift of gathering more information offsite in advance of the onsite portion of the exam, that we ask a lot of questions and we look for a lot of documentation in advance really to enable our examiners to have a full understanding of the bank and any changes that may have happened.

And so, earlier this year, we put together a team to take a look at our pre-exam planning process to see if there were ways -- first of all, we wanted to sort of validate that it was accomplishing what we intended to accomplish by improving the process. But also we wanted to take a look to see, are there ways that we could refine it further. And the good news from my point of view is that it really did confirm what our expectations were, that it really has made some improvements in the examination process.

And the team was also able to identify

some recommendations that we think, on balance, will help us refine the pre-examination process, reduce the documentation and information up-front. Essentially, what our team has recommended is creating a two-step process at the beginning of the pre-exam planning so that we'll gather some questions and information on the front end, you know, to analyze that. Then refine and come back with maybe a second request that's more tailored. That way, we don't have to have a significant amount of documents that were collected that may not be relevant to a particular examination.

So that's a recommendation from our team. We're sort of refining exactly what that would look like, but we're hopeful to implement that early next year. So that's the first thing we're doing to keep updating our community banking efforts.

The second relates to the technical assistance video. And this is a minor update. Back when we launched the technical assistance video program, we produced a video on CFPB's ability to repay roll in qualified mortgages, specifically tailored to community banks and community bankers. And CFPB has made updates to its rules. It was time to revisit that video.

And so, in August of this year, we revised that video to incorporate in particular some of the changes that were affecting community banks such as the change in the definition of a rural institution so that -- which is a pretty significant change because it enables banks that are offering balloon mortgages to be able to continue to qualify those as qualified mortgages.

So we updated that video and released it on our website. As Doreen mentioned, we welcome feedback on other videos or -- you know, the videos that we have out there, if you have any feedback on those or you have suggestions for new videos, we certainly will entertain recommendations from any of you on that.

MS. RYAN: Comments?

MEMBER BEARD: Yeah. Could I ask a question? Maybe it goes more to the research area.

I've noticed over the years there's more and more emphasis on pushing things to the board. And, for community banks, smaller community banks, there's often not a good separation between board and management or the boards of both. Have you considered or do you have something that's studied that? And my concern is that particularly younger examiners tend to push everything to the board level. It's always -- the fallback is always the board ought to be involved in it.

And I think it may be, in my view, is doing some damage to corporate governance, as to the roles of the two respective parties. Have you looked into anything like that?

MS. EBERLEY: Not research, but one of the documents in our Community Bank Resource Kit was a standalone version or issue of the Supervisory Insights Journal devoted to corporate governance for community banks. And that is one of the topics that we discussed, is the difference between management and the board and whose role is what.

We also -- it expands on our Pocket Guide for Directors, which talks about the responsibility of directors, that we first issued in the eighties. The principles there have not changed at all, and they still remain relevant. We updated the pocket guide, but we've got those two resources out.

But it is something that we discuss with our staff and talk about the differences. And the ways that you should see that in examination findings is the difference between the matters requiring board attention page or the matters that are directed to the board of directors that need the board of directors' attention to focus on and correct. Those are issues that, if not corrected, can have consequences for the institution in terms of future earnings or future capital or future viability even. So we really want the board focused on those activities.

And then, in July of this year, our board of directors issued a statement on supervisory recommendations. And so those are the other recommendations within the report of examination that are focused on management, what management needs to do.

What we said in that statement, our board of directors said and we are following, is that any recommendations that we're making from a supervisory standpoint that we're tracking and holding you accountable for will be in writing in a report of examination or formal correspondence from the FDIC. And they'll be in the form of a supervisory recommendation in the report or matter requiring board attention.

MEMBER BEARD: And it may be more of an educational thing because the right or wrong view of the regulators that we're very powerful, I mean, that we have boards that maybe overreact to that in the sense of taking that away from management and creating internal issues because of that.

MS. EBERLEY: Okay. I will just say we have regular examiner trainings so, if you have specific thoughts about how we could incorporate that into our training curriculum -- we're actually just getting ready to start another cycle, but that is something we can focus on.

MR. PEARCE: Yeah. And Doreen just made the point that I was going to make, is that, over the last year, two in particular, I think we have sharpened our focus on how we make recommendations or how we communicate findings to the institution and what the appropriate level for attention related to those things is. So there's obviously always more we can do with training and maintaining that. But that's something we have been working on.

MEMBER HOWARD: I just have to give you some feedback on the approach that you're taking with gathering more information early on in the exam process, the whole exam pre-planning, and I think the result being that we have a more targeted exam focused on, you know, significant risks. And the experience we've had and some of the feedback that I've gotten from several of the bankers in my area is that that process has been very, very effective.

And one of the ways that it plays out that's positive for both -- ultimately, for the sums of the institution is that, during the exam, it allows for a lot more dialogue around the much more critical issues that an institution is facing. And so I would -- you know, I just give you that feedback, that the work that you're doing around getting more targeted and, you know, getting more information up-front about an institution so that the examiners have more knowledge about that particular institution and its risks, they're much more prepared when they come in to complete the exam. And I think we get a better -- you know, a better exam as a result of that.

MR. PEARCE: I appreciate that feedback and, certainly, as Doreen mentioned in her overview of our community banking program, those kinds of conversations between the examiner and the banker has a real value that we think the examination process has. And so having more space for that communication focused on the key critical issues is something we're really striving to do. So thanks for that feedback.

MEMBER TOLOMER: I might add something to that. We just went through our first compliance exam as an intermediate bank, and I think it's healthy to get all of the information to you sooner in the process so that you can study it and, when you came in, you were well-prepared. There was a good exchange of "what about this," "how did this work." And I reserve my rights because I don't have the final report, but the anticipation based on our, you know, communication and the close-out meetings were very favorable.

And I think also dovetails to what you've done in safety and soundness. And I think -- I'll speak for myself, but I think the banking industry in general feels as we all want the same thing. We're giving you the information. You didn't lose it. You didn't ask for copies. You did your work. You came out. You asked. You were receptive to the give and take of what was discussed.

And that's all we can ask. And I think that's fair. And I think it's a vast improvement over, you know, several years ago. So, you know, kudos.

MR. PEARCE: I appreciate that.

MEMBER BAER PAINE: I would like to say that -- Mark, you and I talked last night, and I need to watch the videos. And I really do think they are a good tool. The packet was great that you sent out. I would suggest that maybe you don't physically mail them out but have us go out and download -- I know you want to push the information and possibly sign people up.

There also was -- maybe I'm speaking out of turn, but a lot of us do our training virtually, so we have systems that go through and then they also track when people have done their training, so there's an audit that goes back to that to ensure that they are reading the information that they're pushing out, and they have to accept that.

So it's just another level for us, instead of scanning everything in and distributing it to everybody or asking you to send extra copies, just an option for us to download all the information.

MEMBER EMMONS: Mark, I'm curious, some of our most efficient exams have come when we've had a repeat of examination teams, so that there's a continuity. They know the organization. They know perhaps some of the critical areas in the previous exams, et cetera. And I'm just curious about your philosophy or the FDIC's philosophy as it relates to bringing in new firms or new teams to do the exam, or opting to bring in folks that have been in the prior exams, and do you make those decisions?

MR. PEARCE: Sure. You know, those decisions on the consumer compliance side are, you know, really made at the field level, that supervisors, supervisory examiners are putting together teams. You know, there's an element of that that's sort of resource-based, you know, where are the people we have that are available to do the work that have the expertise.

You know, I do think there's some health in having, you know, not the same examiner, you know, team, you know, complete team on every exam for a period of time, but having people who have different experiences come in and participate in the examination. So part of those decisions that our field supervisors are making are sort of blending that combination of experience and we always are -- you know, as I think most of the folks in this room are, we're always training, you know, new examiners or people with different skills, and so sort of blending those teams. Those are the kinds of factors that lead to the decisions about who's on a particular exam team.

MEMBER HARTINGS: Mark, did you look at the -- or your team looked at the pre-questions and the qualifications, and did you look into FDIC Connect in the sense of maybe a better way to organize the information, maybe a best practices? Because sometimes an area of frustration -- and you ask, you know, 5,000 banks to send you information through FDIC Connect, and we all do it slightly different. And is there a better way to organize that, that it's easier for the examination force to look at things? Did you look at any of that when you were doing your review?

MR. PEARCE: Not specifically for the pre-exam process, although I do think that we've gotten feedback over time around FDIC Connect, and some of the concerns that bankers have raised to us involve the amount of time it may take to upload documentation. And we do have a few -- not a few, at least one or two different initiatives that we think, in the long run, will enable us to gather electronic information more efficiently. And so we're still working on sort of ways to make that technology work to support the examination process, because I do think that's been a little bit of a pain point for some examiners.

MEMBER HARTINGS: I think it's good for the banker, good for the examiner. I mean, I think we're just looking for -- and I hate to say a standard but either buckets to drop it in or just so it's cleaner for you and cleaner for us to send it up that way.

MS. RYAN: Thanks. Great suggestions and feedback. We appreciate that. So, at this point, I'd like to thank Diane, Doreen, Mark, and Jared. And we move into our next session. Doreen is going to stay with us, and Jim Watkins is going to join her. He is senior deputy director in our Division of Risk Management Supervision.

And they're going to continue our kind of discussion about the community banking initiative by telling you about the recent outreach meetings that we've been having on de novo banks and the discussion with representatives from colleges and universities that took place last week in Dallas. So I'll turn it over now to Doreen and Jim.

MS. EBERLEY: All right. Thank you. So we did want to spend some additional time this morning talking about the two important outreach initiatives that came out of our community banking conference earlier this year. And so the first is a series of roundtable events with proposed organizers of de novo institutions, and then other interested parties about the process of applying for deposit insurance.

And then the second, as the chairman mentioned, was the roundtable meeting with universities and colleges offering banking degrees, to further explore ways to partner with those schools -- to partner those schools with community banks, rather, that are in need of new bankers. So how do we put those two together?

And we had a great conversation at the community banking conference about one school that was engaged in an initiative and had partnered with the banking department in the state.

So we'll start with an overview of the de novo roundtables, and then we'll have some discussion about that. And then we'll do the same for the roundtable with the schools. So I'll turn it over to Jim to give us an overview of the de novo events.

MR. WATKINS: Well, thank you, Doreen. And, in your package, there's kind of a sheet that we have that summarizes that the schedule of events for the rest of the year, which the next one is going to be held in Atlanta at the end of this month. And the first event we held was on September 28th in San Francisco, and then that was followed up with an event in New York on October 13th.

And both of those events included about 40 industry participants, either groups of potential community bank applicants or, in some cases, consulting firms, law firms, and other interested parties.

During those events, we expressed our views that community financial institutions are the very core of the U.S. financial system, and that they are the vehicle through which a large segment of consumers, small businesses, and communities gain access to credit and to banking services. In post-crisis period, it has been uniquely challenging for community banks. Yet we remain optimistic with respect to the future of community banking and its essential function in our financial system.

With a long history of community banking, new entrants to the sector have played a role in preserving the vitality of the industry. Along with supporting community banks operating in today's environment, the FDIC is supportive of the formation of new financial institutions and welcomes applications for deposit insurance.

We believe that de novo institutions fill important gaps in their communities and local banking markets. They provide credit and services to communities that are maybe overlooked by larger institutions. Historically, the rate at which new charters have been added to the industry has been highly cyclical, with new institutions highly correlated to periods of economic expansion and strong financial performance of the banking industry as a whole.

FDIC researchers have also found that newly-insured banks can be more susceptible to failure under adverse economic conditions, with a failure rate that can be twice that of established institutions. And that was experienced in the most recent crisis. These findings underscore the importance of promoting the formation of new banks and establishing an effective application process and supervisory program that will ensure new banks adopt appropriate risk management practices and strategies and ensure that their prospects for long-term success are favorable.

We expect chartering activities to pick up as economic conditions continue to improve and normalize today, and we have seen some pockets of activity and increased interest in areas with favorable economic activity or in geographies that have experienced industry exits and an interest in forming de novo institution.

Again, the FDIC welcomes applications for deposit insurance and recognizes that applications require our staff, FDIC staff, to be knowledgeable and available to process and analyze proposals as the industry submits them. To facilitate this, each FDIC regional office has designated subject matter experts or application committees to serve as points of contact for deposit insurance applications. They serve as an important industry resource to address the FDIC's processes and respond to any specific proposals. These FDIC experts describe the de novo application process at our outreach session.

It is a challenging endeavor to establish a community bank and identify and recruiting competent and experienced leadership so that they can provide input and guide the development of a sound business plan. It takes time. It takes work. It takes resources, and it takes a lot of energy.

Additionally, we recognize that the capital-raising efforts can be challenging and difficult as well. Nonetheless, the FDIC to ensure that the institutions created in this post-crisis era are in the position to succeed.

The outreach agenda includes topics that have been outlined in the FDIC's statement of policy on applications for deposit insurance. A statement of policy references the statutory factors that the FDIC must favorably resolve in order to approve applications. The agenda for these sessions covers these topics and discussions relating to the application process and addresses specific filing requirements of the application, the review steps, and the points of contact for each agency.

Discussion of the business plan, its development, and some statutory factors we consider when reviewing the business plan, including capital and earnings are also extensively discussed at the outreach events.

Over lunch, we hear from local bankers who have a lot of experience in forming and establishing -- some at this meeting here. And those have been very favorable discussions that Doreen will touch on.

Again, the FDIC is committed to working with and providing support to any group with an interest in starting a de novo bank, and we will be issuing a deposit insurance handbook to help guide proponents and organizers through the application process. The handbook is being updated to draw on some of the feedback we are obtaining at these outreach sessions, and there's ample room for new bank entrants with sound funding and well-conceived business plans to serve their local market.

It is essential that these new entrants have a clear and identified path to approval, and we believe the outreach events help to achieve that.

I'm now going to turn it back to Doreen.

MS. EBERLEY: And I will say the outreach events were very well received, the two that we've held so far. We had robust discussion right from the very first moment. You know, we had prepared lots of pauses in the program to have discussion, and we didn't need to do that. The discussion, it just happened on its own. And it really was great.

I did want to recognize John Tolomer for giving us what was just a fabulous idea. So coming out of the community banking conference in April, and we talked about the de novo roundtable idea, John made the suggestion that we have the panel of successful de novo bankers to talk about what did they learn through the process. What did they wish they had known at the time, you know, that they know now? What advice would they give to organizing groups?

And that really was -- has been the hit of the first two sessions. So John participated in the first two. David joined in the session in New York. And the discussions were really great.

One of the things that I really enjoyed hearing at the first sessions, one of the questions that was posed to the panel was, you know, knowing what you know now and in the current environment, would you do this again? And everybody said yes. One guy had to ask his wife, because he had told her he wouldn't. So he said that he would be interested in doing it again.

And, you know, when pressed why in the face of the interest rate environment and the challenges that community banks are facing, that same individual said, you know, because every day

I drive down the street, and I can point to small businesses that are there and that have grown and have provided jobs to my community because of me, because of my bank. And I just thought that was such a resounding confirmation of the impact of community banks and the positivity that we hear as we talk to banking groups and the interest that new groups have in forming.

I will tell you that we did take a list of all of the questions that have come up during the sessions. We are making sure that we are incorporating answers to those questions in our handbook. And we are seeing some increased de novo activity. We have had organizing groups at both sessions thus far. We expect the same at our session in Atlanta at the end of the month.

And, since the last meeting of the advisory committee, we have received three true de novo applications that have been filed, and there's been a couple of other -- deposit insurance applications that maybe aren't traditional de novos but are a deposit insurance filing nonetheless. And we do have a number of prefiling meetings that are happening around the country that our regional directors are telling us about. So interest is up. We're starting to see some activity, and very positive about that.

So, John or David, do you want to add anything about your review on how events went?

MEMBER TOLOMER: Well, you go first there.

MEMBER HANRAHAN: I think it was a great event. I'm glad to be asked. I think my most powerful anecdotes were examples of what not to do, you know, mistakes I've made. But it was well done.

With regard to the capital question that came up at the event, I've heard over the years a lot of cries from our industry about, you know, tell us the number. What's the number for capital? I thought your answer was perfect, especially as we also cry for tailored regulation.

The answer that you gave -- and forgive me if I don't summarize it correctly -- was you show us a credible business plan that maintains a Tier I average ratio of eight percent and that you are profitable at, and that's the right capital level. That's the perfect answer to give to an applicant, and I think it was a very good effect.

MS. EBERLEY: Okay. Thanks.

MEMBER TOLOMER: I thought they were excellent, and I thought there was a nice exchange both in San Francisco and New York regarding thoughts and would we do it again. And I think there might be something that I missed an opportunity with Diane Ellis to maybe research is, I think sometimes when de novos have a problem, it's because of pressure. And it could be investment pressure, hey, I thought we were going to make money, or where's my dividend. And they kind of lose sight of what they invested in.

And it might be interesting to see historically how many banks at three or five years or seven years, for good reasons, merged as opposed to having to be merged. And that might be helpful for future de novos to be able to ward off, hey, before you invest in this bank, you have to understand, this is not a short-term deal. And you need to be sure that the CEO, either he or she, is strong enough to be able to communicate to that.

So, as they take the capital and then all of a sudden everyone says, yeah, I gave you the money, and why aren't you profitable six months later? And that's not what the business plan says.

So I think that might be something to be helpful for future de novos.

MEMBER SCULLY: I think that's a great idea because I think managing your investor expectations from the very beginning -- I remember saying to people, don't put this in the income portion of your portfolio. Put it in the growth portion of your portfolio and expect a long-term. And there are many times in the last 12 years where I've had to bring out those slides and show people.

MS. EBERLEY: That's a great point. And I think it speaks a little bit to -- we had a pretty robust discussion at both events about the qualifications of the CEO, the proposed CEO, and needing to have that kind of prior C-level experience dealing with these kinds of issues. It has to be somebody who can deal with the board of directors effectively, somebody that can deal with investors effectively, and really having had some kind of experience at that level.

MEMBER SCULLY: And I'm sure it affects -- I know it affects your process, but I think there are people going into it -- for example, I talk to people who have said, I want to start a bank, and so on and so forth. And, when you ask them who's going to run it, it's somebody who's never been a banker.

MS. EBERLEY: Right.

MEMBER SCULLY: And they go into it thinking that's okay. So managing your expectations as well.

MS. EBERLEY: Yeah. We're going to cover that pretty robustly in the handbook, because it's key. You know, management is the bottom line, most important piece of the process.

MEMBER TURNER: I'd just like to say,

I congratulate you on your efforts. It's a difficult environment, and the fact that you're generating interest is a testament to what you're doing.

This might be beyond the scope of your presentation, but it seems that the FDIC has done a good job in analyzing the past process and determining, you know, what criteria really made banks more apt to fail and more of a risk to the insurance fund, and then pricing their insurance based on that activity.

Jim mentioned that de novos are about -- they're twice as apt to fail. Is that factored into their deposit insurance processing?

MS. EBERLEY: Diane in the room?

MEMBER THOMPSON: Diane is not here.

MS. EBERLEY: I don't know if there's --

MR. WATKINS: There isn't a premium for de novos.

MS. EBERLEY: A premium for de novos, right?

MR. WATKINS: No.

MS. EBERLEY: There isn't?

MR. WATKINS: Makes you want to keep a good record.

MEMBER THOMPSON: This is a curiosity. What part of the country are those brave souls are those three coming from?

MS. EBERLEY: California and Tennessee.

MEMBER BEARD: Very interesting.

MS. EBERLEY: And the interest -- we've had prefiling meetings in Texas, Florida, Georgia -- oh, Georgia, a filing. Connecticut, around the country, so --

MEMBER BEARD: Has there been any study done on the slide of equity from the banking institutions because of a perception that the profit isn't there the way it used to be?

MS. EBERLEY: Not a study, but I'll tell you, anecdotally, just looking at the call report data, a lot of capital came into the banking industry even during and post-crisis. And so it may not have been coming in in the form of new de novos, but it was certainly coming in in the form of supporting the institutions that existed, some through changes of control with new capital coming with a new owner, some from investors purchasing troubled institutions and going for a change of control.

So we've seen less of that as the number of troubled institutions comes down. There's not as much inventory, if you will, for investors to look at. And then I think that's why we're starting to see an uptick in the de novo activity.

MR. WATKINS: I think the other thing we're observing is that the stock market -- the price of equities in relation to book value has improved for institution -- U.S. financial institutions. At one time, it was trading much less than book value, and now it's exceeding book value. And so certain investors would suggest that it was more attractive to invest in existing banks than forming a bank when you can buy it at less than book value. So that dynamic is kind of changing, and that may be one of the reasons why we're seeing a little more interest in forming a de novo.

MEMBER TOLOMER: I think that's a really very strong point because, if you have the option of investing and kind of controlling that, an existing bank is much easier than starting the whole process and, you know, now that that's not available -- or as available, then I think you'll see -- continue to see it.

And I think people will recognize that, you know, it's a great industry. And, as we continue as an industry to make more money and certainly, in community banking, all of the reports that come out, it will attract more people.

MS. EBERLEY: Okay. Can we talk about the event with the schools?

MR. WATKINS: Sure. And let me start by saying that we spend a considerable amount of time at the FDIC having conversations with community bankers and trade associations, talking about some of the challenges that they are facing.

And one of the most significant challenges that keeps being raised is the development of the next generation of community bankers.

To set the stage for our discussion, I'll start by sharing with you some of the commentary we heard at the April Community Bank Initiative conference about this challenge. Bankers spoke about the issue as a talent crisis, if you will. Someone attributed it to the tarnished banking reputation springing out from the overhang of the crisis and partly relating to the lack of current regional bank training programs that some of the larger regional banks would have been offering in the past.

We also noted that there were fewer schools and colleges and universities that are offering community banking program and community banking degrees. Bankers express a desire to hire new graduates and to attract new talent, partly to attract customers and to ensure that their institution would be prepared for the future.

Those that have been able to bring in

some college grads were very positive about their new hires, describing the new group of employees as smart, as hungry, and caring about their jobs and wanting to do a good job and support their communities.

Another responded that community bankers really need to tell their own story, tell their community banking story and how it helps to bring jobs to the community and serve the local market. And that would help to attract students to consider community banking as a career.

As Doreen mentioned, on October 27th, we hosted a meeting in Dallas, and we called it the Developing Tomorrow's Community Bankers, a discussion between educators and the industry. Our chairman was at the meeting and kicked it off. And, at the meeting, we had both representatives from the banking community and the academic communities.

They're ready to start a dialogue about how they might partner in a mutually beneficial way to develop the next generation of community bankers. The purpose of the dialogue was to explore community banking educational programs and to identify and discuss challenges and best practices of those programs in the experience of the participants.

The college and university professors described their programs and some of their school's course content as well. The trade associations expressed the need for new bankers and the opportunities for new college graduates to serve in banking, as long as they have an interest in banking.

The groups gathered that they represented 10 colleges and universities from the states of Arkansas, Indiana, Mississippi, New Mexico, South Carolina, South Dakota, and Texas. Also attending were representatives from the American Bankers Association, Independent Community Bankers of America, and Commissioner Charles Cooper with the State of Texas was representing the state, of course, and also representing the Conference of State Bank supervisor.

I would describe the meeting as being very productive and interesting. The schools expressed a strong interest in partnering opportunities, internship opportunities and discussions to help attract students to banking. There was a really strong desire to explore additional steps that they could possibly take as well.

For example, one of the suggestions might be to develop perhaps a directory of schools and colleges that might be offering programs, establish some contact points. Some of the schools discussed having advisory panels for the schools themselves with community bankers, and that's a good way to understand the needs of community bankers and attract students as well.

So I think I will stop there and ask if there's any -- if you have any additional thoughts or comments on that, or something else you might want to suggest.

MEMBER SCULLY: What about some of the

metrics? How many people are going through these programs right now? I mean, just the magnitude.

MR. WATKINS: So it depends on the school. So we just had maybe a sample of the schools that we identified. And, you know, in some cases, there could be groups of 30 to 60 students interested. But there is a higher demand for those students than there were students available. In other words, some of the universities were suggesting that they could attract more students to fill the demand.

We were also told -- the college professors indicated that there's kind of a funding issue at a number of colleges and programs. They've had budget cutbacks and are always looking for ways to partner as well.

MEMBER BEARD: Well, I commend you to focus on that. We were involved in this award that the Federal Reserve and the CSBS gave. They studied community banks and how they came through the recession. And the University of Utah did the study, and we received an award for that.

But the thing I learned from it was that it's not at the top of the mind to the university students to think banking. They think of lawyers, doctors, mechanical engineers. And that is just fascinating, this team that the university put together. A number of them -- I remember one young lady who expressed -- she said, I never even thought of banking beyond being sort of a teller. And now I realize that there's a whole industry there from this study that we went through.

So I think we could do a lot better job maybe all the way through banking to let young people know this is an honorable way to make a living. It's supporting the communities. And, if you have an interest, the banks are very interested in internships and trying to bring young people into this. I'd be very supportive of that.

MEMBER HARTINGS: Did you study any of the interaction between the banking schools that we have that are around the country and the actual degree? I mean, were they represented as well at this conference?

MR. WATKINS: So you're talking like a graduate banking program?

MEMBER HARTINGS: Yes. Yes.

MR. WATKINS: Some example, the ABA helped us to sponsor one of those programs itself, so they were represented in that regard. We do include the graduate banking programs in this particular session. They generally help to educate and provide training for individuals that are already in banking.

MEMBER HARTINGS: But there's also a numbers of schools. I know the Barrett Banking School is more of an intermediate. And I just wondered if they looked at what courses might be to the advantage of curriculum of college study that would be an important course.

And then does FDIC make any of their instructors available? You know, I think about the training that you do for your examiners, and you have a wonderful program that you -- I'm sure great instructors in those programs. Do you make those available at all -- to universities on a, you know, as-needed or adjunct basis? I'm not sure how you would make them available.

But I just -- it's interesting to kind of have that. And, you know, that's a part of being in banking, is understanding that side of it. And to be able to bring out experience, that would be great if you could share that somehow.

MR. WATKINS: I think that's a great question. I'd be curious to know if others feel we should -- if that's something we should offer up to some of the colleges, is to provide some expertise. We for the graduate -- We're very active in that. And we do a lot of outreach. But that's something we should consider.

MEMBER BEARD: We do have at the University of Utah, Brighton Dallas East, I don't know if you know that name, but he's one of these people. That's where he teaches, of course, there, and it's been successful in stimulating some of what we're talking about.

MEMBER THOMPSON: Where do --

MR. WATKINS: I'm sorry.

MEMBER THOMPSON: No, go ahead.

MR. WATKINS: Go ahead. Please.

MEMBER THOMPSON: Where do you see this program continuing to go, and is there anything as community bankers that we need to be doing to help promote this further?

MS. EBERLEY: I think one of the interesting questions that came up during the event, and I certainly may want to expand on this, is that, you know, would there be benefit to facilitating regional meetings like this to that end, and seeing how local universities and local bankers or state banking associations could partner.

CHAIRMAN GRUENBERG: This is really an initial engagement for us as a group of academic institutions that are offering banking programs. Essentially it's for us to begin the process of getting informed about what's available, how these programs are structured, are the students that participate and what the possibilities are going forward.

So I think that literally this meeting was last week, so we're talking a little time here. And I think we're going to sit there and try to think through, I know we can move from here. And I do think there is a lot of potential here.

And it seems to respond to a need that certainly I hear frequently from bankers, the need to attract talented young people with an interest in banking. And these programs are a vehicle for developing students and, to the extent bankers have opportunities to offer, there's obviously a complementary interest there they would like to build on.

So I think we want to get to know these programs a bit better through the sense of what they offer, the students they attract, their relationships with their banking communities already, and what are the possibilities for us to expand, you know, things to think about. Are there opportunities to expand the working relationships at the existing programs they have with their banking communities? How well-informed are bankers about the programs?

There right now is not a national directory of all of the colleges and universities and business schools that offer banking programs. There is that information gap, in effect, that we think the FDIC may be able to fill. And, you know, there's not a rule that says a community bank has to attract people just from the local school. There are programs around the country graduating students with an interest in community banking. Every banker should have access to that information and potentially draw on students graduating from those programs.

And also identifying schools in cities and communities that are not currently offering the program but for which there will be a local interest.

So this strikes us as having significant potential. And, to the extent you all have any thoughts on this, you would be very much welcome to the things we could do with the local banking groups of things we could give to facilitate.

So we're starting out here, but this seems to respond to a general need and issue, and I sense there's some potential here. And so I feel really positive about the meeting last week, and this is something that we will focus on going forward.

MEMBER TOLOMER: I like all the effort. I think it's spot on, and I think the -- you know, we don't care if we hire somebody local or -- with credentials, these type of credentials, or somewhere else across the country. That's fine.

And I think also, while the schools have always promoted the Wall Street investment banking, those jobs are shrinking, and community banking is thriving. And there's more jobs. And there's nothing wrong with being involved in a community bank. And so I think there may be a job here for us to help the schools understand.

And I heard a horror story recently where somebody graduated and did not take a job on Wall Street, but went to work for a community bank.

And the school was aghast at how that person made that choice to go work for a community bank, and got pressure to make a phone call, saying, you're not going to go to the investment banking firm, you're going to go work for a small bank?

So, you know, I think we certainly have ambassadors at this table that would be more than willing to do any PR or any introductions, but I think it's a great idea. And I think it will help build, you know, community banking. We're not all bad guys, you know. We're involved in the communities. And so I applaud the effort.

MEMBER SCULLY: And we even have young people working for us who think banking is a great career, who might be willing to talk in that way.

CHAIRMAN GRUENBERG: I think the education started with the schools and it would be the same from the banker's perspective with the schools would be pretty important. I think community banks have a very positive story to tell about the opportunities and benefits of working for a community bank.

And this was an issue that came up, I think, at the meeting last week with the institutions, with the academic institutions, where opportunities are limited. And there actually may have been more opportunities available with community banks. And the students needs to be made aware of it.

The first thing on the minds of students today graduating are finding positions. And, if community banks are the source of opportunity, and offering jobs with real career prospects, there's a match there. So it really struck me as something we can work on.

MEMBER MENON: I think we really need to invest in the fact that the schools are having budget problems. They don't have the funding to go to a new program if they don't already have it. Maybe it would be beneficial if somebody were to put together some sort of where do you go to get a grant or something of that sort, so that the universities can raise the financial resources to be able to fund the new program.

And whether it's a public or private partnership or whatever it is, that would be helpful, I think, to the schools.

MS. BOEKA: But more targeted to increasing the number of students because that's what I heard. And you can do that early on, probably high school, before they embark into college, trying to sell up this side of the business in competition with the investment banking.

But, if we don't increase young people's, at the high school level, to have an attraction to banking, then it is very hard to compete once they're there at college, to think that they're going to go to that firm and make all of this money buying and selling.

So probably start a little bit earlier and say, I haven't done it with only 30 people in an organization. But that would be where I would go start a conversion.

MEMBER BAER PAINE: To your point, Adriana, have you talked to any of the state commissioners, you know, specifically that demographic is very interested in financial literacy. And so, if you start that financial literacy, could you indicate at a younger age, and high school age, I mean, that does pique interest in and maybe a combination of educating our young and piquing interest in possible next generation leaders.

CHAIRMAN GRUENBERG: And I think the state commissioners have a role to play here. Charles Cooper from Texas is currently the chairman of CSBS, so we would want to include them in this effort, because there's a common interest on both sides here, I think.

MEMBER DAKRI: Well, I think this is a huge issue for every community bank out there, attracting the talent that's needed. I mean, I assume most of us here, we have all of the people in the banks are eventually going to retire, and how do you replace that talent? How do you get the new blood into the bank to let you be more aware of what is going on in today's society.

And I think one of the interesting

things we have here is basically marketing. How do you market a community bank, not only to the generations that are going through college, but to the colleges themselves? While Wallis State Bank might not be a household name anywhere outside of Dallas or Houston, FDIC is. People understand who the FDIC is.

So I think a partnership between the FDIC and the community banks and the universities is important because your name recognition is much greater than ours.

CHAIRMAN GRUENBERG: I think this is very much consistent with our mission, so that I think we are very open to the many ways to cooperate and be supportive here.

MS. RYAN: Before we take a break, I did want to come back to a question that came up about community bank assessment rates. And Diane is here, so it makes sense, while we can return to that question and give Diane an opportunity. Do you need to --

MS. ELLIS: I understand it was a

question about how we assess de novos.

MS. RYAN: Right, and are they assessed differently --

MS. ELLIS: Yes.

MS. RYAN: -- looking at the higher failure rate?

MS. ELLIS: Right. Yeah. De novos -- the bottom line is de novos are assessed at a flat rate. Right now, I believe it's nine basis points. It's the top of our risk category one. When we put our -- presses a transition, which we're going to explain to you in 20 minutes here with the next session, that'll drop to about seven basis points.

And the reason is that, for community banks, for small banks, our assessment system is based upon a model that uses financial – call report information, financial information, to project the probability of failure. And de novo banks, as you might suspect, just don't look like other banks. You know, the balance sheets and income statements aren't the same as a well-established bank. And it's really virtually impossible to model the performance of a de novo bank.

So, since we put this system in place, you know, 2007, de novo banks have always just been charged a flat rate because we couldn't think of any better to do it.

MEMBER HARTINGS: What's the time frame of that flat -- so, if I'm a de novo that starts up to --

MS. ELLIS: Five years.

MEMBER HARTINGS: Five years.

MS. ELLIS: Five years.

MEMBER HARTINGS: Five years.

MS. ELLIS: Right. Yeah.

MEMBER HARTINGS: Has it always been five years?

MS. ELLIS: Yes, it's always been five years. Was there another question about research on de novos?

MS. RYAN: Oh, there was a question.

MS. ELLIS: Yes, yes.

MS. RYAN: Some questions came up.

MEMBER TOLOMER: What I was thinking, we were talking about the formation of de novo, and I thought one of the things that would help the organizing group is to understand how -- because, you know, people have different perspectives, and I think Mary Ann was very blunt in her presentation saying, if you need this money, if you're looking for income or you're looking for anything to happen fast, forget it. I know I did that as well.

But yet people have this idea that, oh, you know, in three years we will double our money, we'll get two times book, three times. And I was wondering if there was any research to be able to arm organizing groups with investors to say -- have de novo where five transactions in year five, for positive reasons, not banks being taken over, but where there are, you know, people selling for premiums in a short period of time.

So a new de novo bank saying year five, year six, how many have, quote, "flipped." I mean, I suspect the answer is going to be pretty low, but I would be interested -- it would be an interesting fact.

MS. ELLIS: Yes. We have done some research on de novos. I don't know that it gets specifically at that question, but -- or we have an economist or who released a working paper within the last year on the performance and viability of de novo banks. So it was more looking at how did they mature, which ones survived, which ones failed.

I mean, sort of at a bottom line, it might not be surprising -- be surprised at the high-level conclusion that de novos fail at a higher rate than other banks. So, but I don't know that we -- we didn't really get into, you know, the ones that sell or merge, you know, how does that work.

But it would be perhaps an interesting area of further research, and she is doing some ongoing research in the area of de novos, so it might

MEMBER TOLOMER: It might just be something that --

MS. ELLIS: Yes. I might ask her if she wants to take a look at that as an area for --

(Simultaneous speaking.)

MS. ELLIS: We are looking at consolidation. Now we have just an -- internally, every quarter we are kind of looking at the trends in consolidation. And like for the -- it was sort of at a pretty high rate, but then the second quarter it slowed down a little bit. But the premiums -- at the same time, premiums on transactions that did occur, you know, dropped quite a bit.

MEMBER SCULLY: Can we look at it by vintage? Because that might sound --

MS. ELLIS: Do you mean "vintage" like the age of the bank or --

MR. WATKINS: So some of those transactions would be private sales, though, of non-publicly traded companies. And then so we would have call report information and data that the banks file. But as far as the premium on, you know, sale, that -- that wouldn't show up in a call report filing. That would be from the sales, and if it's private we wouldn't necessarily know unless it was announced publicly.

MS. ELLIS: But that's -- I see where you're headed. That's an interesting area.

MEMBER TOLOMER: You weren't here. The backdrop was I -- I suspect that as de novos fail it is related a lot to pressure, and the pressure can come from your models not working; what's your contingency? It could come from your investor pool saying, "Hey, where is my dividend? Hey, what is going on here? I thought this was going to be three and out or five and out." Because they have a dream, they have a perspective, whether it's right or wrong.

So at least before they invest their money, the organizing group can say, "Look, that's the dream. Here are the facts. This is good, hard data." So if this is what you're thinking about, this is not the place to be, this is a good long-term, be part of the community and build your business and help us build a business. Our shareholders have been fabulous for --

MR. WATKINS: I think I would suggest for investors, if they are looking at banks, they should say, are they sticking to their business plan they identified when they did their offering? Or are they deviating from the business plan, and are they doing it with high growth and unstable funding basis? And I think that's where you would see a lot of the issues that -- for banks that ended up failing.

MS. RYAN: Okay. So it's time to take a break. So we'll reconvene again at about 10:45.

(Whereupon, the foregoing matter went off the record at 10:31 a.m. and resumed at 10:55 a.m.)

MS. RYAN: Okay. Welcome back, everyone. Our next session is designed to provide all of us with an update on FDIC assessment rates. And as I'm sure you're aware, the reserve ratio of the FDIC's deposit insurance fund is going -- is now above 1.15. So I'm going to let Diane Ellis, who you already know, and Matt Green from the Division of Insurance and Research, are going to explain to you what this means for your assessment rates.

MS. ELLIS: All right. So this morning I brought -- had Jared Fronk with me to talk about the research side of the Division of Insurance and Research, so this time I've brought Matt Green with me to talk about the insurance side of the Division of Insurance and Research. And Matt is going to just spend a few minutes here talking about why crossing this 1.15 percent threshold was important and what changes that is going to bring about.

MR. GREEN: Thanks, Diane. The deposit insurance fund balance stood at $77.9 billion on June 30. That's an increase of $2.8 billion from one quarter earlier. The reserve ratio, which is the fund balance as a percent of estimated insured deposits, rose to 1.17 percent at June 30th from 1.13 percent at March 31st.

Under our regulations, three major changes in positive terms assessments begin the quarter after the reserve ratio first reaches 1.15

percent. Therefore, the changes actually took effect beginning in the third quarter, and they will see these changes in their quarterly -- third quarter invoices which they will receive in December.

First, overall initial assessment rates for all institutions have declined from a range of five to 35 basis points to a range of three to 30 basis points. Second, because the law requires banks that have total assets of $10 billion or more to bear the cost of the increase in reserve ratio from 1.15 percent to 1.35 percent, large banks are now subject to temporary assessment surcharges. At this time, we are projecting that the surcharge will last eight quarters and will total approximately $10 billion.

Additionally, small banks will eventually receive assessment credits for the portion of their assessments that contributes to the increase in the reserve ratio to 1.35 percent. We are projecting total credits of approximately $1 billion, and the FDIC will apply these credits to reduce the assessments of small banks when the reserve ratio is at or above 1.38 percent.

The third change is that a revised method to determine risk-based assessment rates for banks with less than $10 billion in assets also went into effect in the third quarter. This revised method was developed using data from the recent crisis, post-crisis years, and earlier periods in order to better reflect risks to the insurance fund.

Under the revised method, total assessment revenue collected from small banks is approximately the same as it would have been under the prior risk-based pricing method. So as a result of these assessment changes, most community banks will see reductions in their deposit insurance assessments. We are estimating that assessments will decline for 93 percent of institutions that have less than $10 billion in assets. In aggregate, quarterly assessments paid by small banks are expected to decline by about one-third.

Banks are not going to be required to report any additional data because of these assessment changes, and they can estimate their assessment rates using the FDIC's online calculator. We also have an assessments helpline that many of you are aware of that we've had for several years to answer any questions about these changes.

And with that, I would certainly open it up just to questions.

MEMBER HOWARD: So I just have a clarification question. Ninety-three percent of the small banks should see a decrease, but did I understand correctly that the amount of premiums that will be paid into the fund by small banks will increase?

MR. GREEN: No. No. The amount of premiums that were paid into the funds by small banks will decline, and we're estimating by approximately one-third, a 33 percent reduction. That change, combined with the change in the risk-based pricing method that we -- we went out for -- we had a regulatory process with last year and earlier this year -- will result in 93 percent of small banks paying lower than seven percent with an increase.

MEMBER HANRAHAN: Matt, could you please elaborate on the credits, what they will ultimately get back for the -- the difference between 1.15 and 1.35? Is that being -- it's as if all of the premiums will be credited back, or a part, and if -- if part, what part? How is that going to be calculated?

MR. GREEN: Okay. It's a part. It's the part that contributes to the growth in the insurance fund. I can -- every bank's premiums also have to cover the losses, expenses, regular growth and insured deposits, even to maintain a reserve ratio at 1.15 percent.

So we're going to be crediting back the portion that -- it contributes to the increase, which we can calculate. I don't know if you want an example or not. I can --

MEMBER HANRAHAN: If you are prepared

to give an estimate of what part that might be, that would be --

MR. GREEN: Sure. So let's say right now that -- these are always subject to uncertainty -- that we will reach 1.35 percent in 2018. At that -- let's say we -- at that quarter where we reach that goal, the minimum target for the reserve ratio, we will calculate .2 percent of insured deposits, which is the difference between 1.15 percent and 1.35 percent.

And let's say that amount is approximately $15 billion. Well, then, look at that $15 billion and say, well, we know that a portion of that comes from the surcharges paid by large banks. We're estimating that would be about $10 billion, leaving $5 billion coming from the regular assessments of all banks that contributed to the increase in the reserve ratio.

Of that $5 billion, a portion of that comes from small banks. Currently, that number would be about 20 percent, so that's about $1 billion, which is consistent with our current estimate.

MEMBER HANRAHAN: So as a fraction of what I'll pay over the next couple of years. Are you prepared to say what that might be? But 150 grand over the next two years, in terms --

MR. GREEN: It is -- it is -- I think it's under -- it's maybe between a third and a half, but I'm not positive about that. I'm thinking it's somewhere -- it's somewhere around four or five basis points, something like that.

MS. ELLIS: So, obviously, the big -- the big wildcard here, we aren't going to know for sure until after the fact. The big wildcard is insured deposit growth. If insured deposit growth is really rapid, people -- we're going to need a greater portion of regular premiums to cover that. Or if we have -- we're not projecting much in the way of failures over the coming -- but if something happens, there is a big failure, more regular premiums are going to be needed to cover that.

Conversely, if insured deposits grow

slow or, you know, we have, you know, even fewer failures, then more -- more of the regular premiums would be returned in the form of a credit, so --

MEMBER HOWARD: Can you explain the revised methodology for -- I think it's for small banks.

MS. ELLIS: Sure. Yes, yes. And, actually, we came to this group a couple of meetings ago, but you -- for the new people on our committee, it's -- the new assessment system is -- sort of looks and feels like the old assessment system in the sense that it's a set of financial ratios and CAMELS rating that are used to calculate an assessment rate. So it doesn't -- it doesn't feel like a dramatic departure from that.

But underlying the choice of those ratios and the weights placed on them, there is a change in the model currently. The old system was put in place in 2007, so -- and, really, the analysis was done in 2006, so pre-crisis, and it was -- because we had gone through such a long period of time without any failures, we were reluctant at that time to do a failure projection model.

We instead did a CAMELS downgrade model, because we had more recent information. And we looked one year ahead at what the likelihood of a one or two rated institution was being downgraded to a three or worse, and used that as a proxy for failure.

So, but post-crisis, we wanted to update our system to take advantage of the new information or lessons data we had from the crisis, and at that -- and so we changed to a failure projection model, since we have all of this recent data. But we didn't use data from just this crisis, we went all the way back to previous crises as well. So it's a very long period of time, but failure data and it looks three years ahead.

So based upon our experience and all the data we have, what is the likelihood that a community bank is going to fail within -- over a three-year time horizon. So that underlying model is different but, again, it produces a set of financial ratios and CAMELS ratings and -- that we use and, you know, it drives the choice of the ratios and then the weight we place on those ratios.

MEMBER HANRAHAN: These are really good changes. In particular, I want to say thank-you for treating reciprocal broker deposits differently under the new formula. That's a subject that I and many others have argued for how those really aren't going to behave, don't believe like true broker deposits, and apparently you recognize that and treated them that way. So thank you.

MS. ELLIS: Yes, thanks. There's really no change in the treatment of those -- from the old model versus -- the old system versus the new system.

MEMBER HARTINGS: Could you just expand on the credit question again? Will you also take into consideration where that growth of deposits would be in a fund? So if it -- growth of deposits is -- you talked about from 1.15 to 1.35, got to factor that in there. But if that's done, growth is primarily by those banks above $10 billion, will that affect that credit formula as well?

MR. GREEN: No. It's -- we just will look at -- once we reach that 1.35 percent minimum target, the rule would say that we would look at estimated insured total insured deposits in the banking system at the time, regardless of where the growth came from.

And then we'd calculate .2 percent of that, which is the difference between 1.15 and 1.35. And that is the -- that represents the dollar amount responsible -- you know, that brought us from 1.15 to 1.35, of which we know surcharges cover part of that and assessments by large banks and community banks cover the rest, and we would do that calculation that way.

And that's where we -- we calculate that approximately. At this point, our best estimate is about $1 billion would be the contribution of community banks to increasing the reserve ratio of 1.15 to 1.35 percent, which Congress requires us to offset.

MEMBER HARTINGS: With that same process, thought process -- and maybe I'm not understanding that -- if we wanted to keep it at 1.15, and all of the growth, you know, over the next two years was by a bank over $10 billion, it would be somewhat their responsibility if there was no losses. And that's what I'm saying is, shouldn't that be factored in there somehow?

MR. GREEN: Well, I guess it's no different than the current system in that sense that insured deposit growth from wherever it comes from is the responsibility of the entire banking system when attempting to maintain even a constant reserve ratio. So it's not -- we don't necessarily look at, well, this quarter, mid-sized banks or community banks grew faster, insured deposits rose faster than others, and it does go back and forth, but --

MEMBER HARTINGS: But the only difference is it's regulated that those larger institutions above 10 billion do pay that 20 basis points, so that does make it somewhat different than what we look at today. So --

MR. GREEN: Right.

MEMBER HARTINGS: Okay. Thank you.

MR. GREEN: Okay.

MEMBER TURNER: I also appreciate the work you've done. You know, I think our premium will decline slightly. My question is, you know, there are certain kinds of lending that seem to be -- maybe "disfavored" is too strong a word, but that, you know, affect negatively your insurance premium, one of them being construction development lending.

And I agree certainly during the last recession that was definitely more risky, but at least in my own experience, and we bought five banks from you guys as they failed, and looked at a number of others, and it was a very -- kind of a specific center of construction development lending, land development, where it was extremely risky, maybe speculative constructive, was very risky, you know, a properly structured project, office building, retail, long-term care apartment, whatever, with acceptable equity levels, at least anecdotally didn't seem to be any more risky than other sorts of lending.

Have you thought about sort of trying to collect that data so you can really zero in on what seem to be more risky?

MS. ELLIS: Sure. Yes. And you've hit upon -- in terms of the -- I sort of describe the overall conceptual change in the approach, but you've hit upon the one ratio that is probably the biggest departure, the biggest change from the old system, and that is -- we call it a loan mix index, and it's essentially a concentration measure.

And it does -- it is based upon our data which show, you know, which lending types, which concentration of lending types, resulted in the highest number of failures, the greatest number of loss. And it is -- construction certainly stands out compared to the -- C&I is next, but it is sort of a distant second, and it is based upon not only this crisis but the previous one as well. In the

'80s and '90s, you know, heavily concentrated C&D lenders failed at a much higher rate.

In terms of the question -- we often get -- in notice and comment rulemaking, we often get comments saying, "Why don't you incorporate underwriting," which is kind of what you're saying. And, obviously, we don't collect data which directly speak to underwriting. I mean, we are including certain ratios that maybe indirectly get at it -- past dues, chargeoffs, profitability. You know, to be any more granular would require an additional data collection, which we didn't think there was much appetite. We didn't think there was much appetite for that. So we were trying to deal with the data that we had.

MEMBER TURNER: I guess what I'm saying is maybe a little bit different than underwriting. It is really project tied. I mean, I see a difference between a land development loan or a speculative construction loan versus our customer wants to build a new headquarters and is willing to put acceptable levels of equity in it, or we have a customer that wants to build a long-term care facility and is willing to put acceptable levels of equity.

I mean, my guess is those didn't present any greater levels of default in the last crisis or the one before that than other kinds of lending. I may be wrong, and I just -- you know, I don't know if you guys have the data to determine that, or maybe you don't.

MS. ELLIS: No, really -- no, what you're saying intuitively makes sense. I mean, I wouldn't be surprised if that were the case. We don't have the data, and maybe someday when the industry is -- when the data -- when collecting and reporting the data is maybe a little easier --

MEMBER TURNER: Right.

MS. ELLIS: -- we'll be able to capture things like that.

MS. RYAN: Anything else? Okay. If not, thanks, Diane and Matt.

So now we're going to turn to consumer compliance issues, and among various things to be discussed will be affordable mortgage lending guide, flood insurance issues, consumer compliance rating systems, and the Military Lending Act. And so to discuss these issues joining us are Mark Pearce, Director of the Division of Depositor and Consumer Protection, and we have Luke Brown and Janet Gordon, who are associate directors in that same division.

So at this stage I will turn the mic over to Mark.

MR. PEARCE: Thanks, Barbara. Thanks for having me back. Before turning over to Janet and Luke to talk about some of the things we have been doing in our Division of Depositor and Consumer Protection, or other regulatory matters that may be of interest, I was struck by the conversation earlier talking about recruiting and training the next generation of community bankers and the suggestion by a number of you of going down earlier and reaching people earlier with financial capability, financial literacy, and getting them into the banking system.

And I wanted to at least note last -- last Friday?

MS. GORDON: It was indeed.

MR. PEARCE: Last Friday we had a youth savings symposium. We had been running a pilot project for a couple of years where we -- bringing together bankers and schools together to help educate young people about financial matters and also pairing them up with actual accounts in insured depository institutions.

And I think -- as you were talking, one of the things that really just struck me about our youth savings pilot and our symposium were the stories we had of young people. In some cases, they have been involved in operating a bank branch, a student-run bank branch, you know, individuals in the school. And that process has not only been helpful in promoting financial education and literacy, it has not only been helpful in helping them establish a banking relationship, but it has also led them to demonstrate interest in the banking sector.

And so we actually had some really nice stories of -- of at least a couple of individuals who had really no interest or awareness of banking at all, got involved through, you know, the opportunity to serve in one of these student-run branches, and then have pursued since then a career in the banking industry.

So your point is right on tap and I think really resonates with our experience with the youth savings program that we have been operating.

That is actually a pretty nice segue to turn it over to Janet Gordon. Janet is the Associate Director of our Community Affairs Program, and her area of responsibility includes the youth savings program I just mentioned, but also a number of other areas that we have been working on to try to connect populations, consumers, small businesses, communities, to the insured financial institution sector, so believing that promoting public confidence depends in part on how well the insured financial -- insured depository institutions serve the broadest possible set of our population's financial needs.

And so Janet is here to talk about the one effort that we have been working on related to helping community bankers in particular serve mortgage credit needs of members of their community. So I will turn it over to Janet in a minute, and then we have Luke Brown here, who is the Associate Director of our Policy Group, to talk about some of the regulatory -- recent regulatory changes that may be of interest to you.

So, with that, I will turn it over to Janet.

MS. GORDON: Great. Thanks, Mark. It is great to be here. I haven't been here before. And as Mark explained, I manage the community affairs staff, including staff in our regional offices.

Today I am introducing this committee to the affordable mortgage lending guide, an FDIC publication, and the affordable mortgage lending center, which is an online resource. So you all have the brochure in your packet.

These resources showcase affordable lending programs in three parts. Part 1 covers federal and government-sponsored enterprise programs, and those programs are listed on the brochure. And that publication and the guide and the online resource was released on September 15th, in conjunction with a roundtable we held in St. Louis, Missouri.

Part 2 covers state Housing Finance Agency programs. And if all goes well, that should be released today or tomorrow, and it looks like this with a map of the states. And, of course, with technology, online you click on a state and you get the right programs for that state. So we hope to -- we hope all that clicking works.

And, finally, at the end of the year, we will publish a guide on the Federal Home Loan Bank programs. So it will really cover the waterfront. And the links to access these resources are at FDIC.gov/mortgage lending.

So these tools are really designed, as Mark said, to be resources for community banks and others who want an authoritative overview of affordable mortgage lending programs, and they also provide straightforward information on how banks in particular can access the programs, whether as an originator, a correspondent, or a direct seller. So it's unbiased in terms of how you get into the business, and really encourages people to explore however they can the way of accessing these programs that is right for them. We know it's not one size fits all.

So I'd like to just give you a few more minutes about why we did the guide, its origin and purpose, the scope, and then talk to you a little bit more about our plans for outreach and maybe there are some ways we can work together with one or all of you to expand knowledge and awareness.

So in the beginning, we know that the chairman and DCP leaders talk a lot about FDIC's commitment to economic inclusion, and that is most of what the community affairs group does. We try and get -- promote the widespread availability and effective use of safe, affordable, and sustainable products from insured depository institutions in communities, so, really, try and connect banks and communities.

We recognize that mortgage lending is one product that can certainly be a significant gateway, and it's a gateway to mainstream banking. It is also often an important part about how community banks get connected to customers for very long-term relationships. It's nothing longer than a 30-year mortgage, keep selling people different things, right? That statement is not fair. And it also gives you a lot of community visibility.

So about two years ago we met with a series of outreach events with community bankers. We went to Las Vegas and Chicago for roundtables, and then we also met individually to understand how bankers were really using these programs and products in what we will call the new environment, right? Post of the new regs, post the crisis, things are just starting to pick up.

And we heard from bankers that there are still a number of barriers to affordable lending. I mean, for one, supply of affordable housing is still a problem, still coming -- in some places still a problem. We also heard from lenders that the complexity and number of affordable mortgage programs can be a barrier, and that it might sometimes make it difficult even to know where to start to make those business relationships happen.

And then others told us that they are doing a great job. They have no problem getting access, and they gave us some sort of best practices ideas. And they also suggested we collect and organize this information, so that's what the guides were designed to do, and we did it the modern way, mostly online.

The coverage is pretty comprehensive. The guide and the center cover guarantee, loan purchase programs, tax credit, subsidy programs, even different kinds of home ownership education requirements, and covers federal GSE, and actually, as of today, the state programs.

So, and you'll find the requirements of

each program as well as, as I said, how bankers particularly access them, and it discusses technical information about borrower and loan criteria. So we know that this is current today, but we will have to maintain it over time as well, because nothing changes faster than the housing market.

In the community banker conversation sections of the guide, so we had these conversations and we actually put summaries of them in the guide, we specifically focused on how the banks were using the programs. And in Part 1 we have a lender who talks really about how significant the VA program is in his market -- of course, in some markets, there is a particular concentration of veterans -- and how his relationship with a partner investor allows even his very small institution to originate into the market.

And in Part 2 a Kentucky banker talks about using the mortgage tax credit certificate, which is a program that is not all that well-known but which state housing finance agencies manage, and his comment was that it really promotes affordability for low and moderate income buyers and is actually worth the time to fill out two extra forms. And we all know that these programs generally have a few extra forms.

(Laughter.)

MS. GORDON: But his feeling was that, you know, it really expanded his market enough to justify that. And the Part 2 guide with the state housing financing agencies, which is hot off the press, and if you want actual copies of the guides, they are going to be outside, but we understand that you might prefer to point and click.

So it really does focus on the full range of state programs. And our understanding from both the states and the federal home loan banks is that even if bankers are engaged they may not always use the full range of programs, or they may not even have a good menu, and what we learned is that there is not even one place where all of the state programs are on one website. And now there is, and we are happy to do that.

So our efforts continue to encourage knowledge-sharing about affordable lending. We have team members who have organized or presented at about 18 affordable housing roundtables or events this year, whether sponsored by us and our fellow regulators or sponsored by state housing organizations.

We have been trying to get the word out, and we have reached out to ABA and ICBA to engage, and they put us in their newsletters. And we're thinking about how to work together to sponsor workshops.

But we are very interested in your feedback on the center site, and you can click to provide it, or you can email us. And you can also sign up for our updates, you can become a subscriber, and you can feel free to contact me directly or any of our regional team members -- and the regional addresses are on the back -- to recommend if you think we should present somewhere, if we should convene bankers and any of your favorite or not-so-favorite federal program leaders.

We have managed to get, you know, FHA, VA, and USDA to the same event. And, really, they have been increasingly improving their presentations to us. I think they are beginning to see how even better to connect to community banks, and that's one of our goals as well, to sort of bring them to the table with more appetite for certain community banks.

And we really hope that the programs in the guide represent an untapped potential that can be used to improve and strengthen the pathways for home ownership for creditworthy borrowers who have affordability problems, and also hopefully represent business opportunities for community banks.

So we are interested in any ideas you have. A website is always a moving target, and we would like to improve it and strengthen it.

MR. PEARCE: Thanks, Janet. Luke, do you want to provide an update on some of the consumer compliance issues?

MR. BROWN: Sure. Good morning, everybody. I am going to walk you through several consumer compliance topics, including one focused on flood insurance, a proposal that we recently issued, a ratings guidance update, and a summary of our MLA implementation work.

On Monday of this week, the FDIC and several other agencies announced a joint notice of proposed rulemaking related to flood insurance. You might have seen that come out. The proposal would specifically require that lenders accept flood insurance policies that meet the definition of private flood insurance under the Biggert-Waters Act.

The proposal is open for public comment. It has not yet been published in the Federal Register. We expect that to be published soon, but it will be open for 60 days after the publication of it in the Federal Register.

By way of background, the federal flood insurance statutes may federally subsidize flood insurance available to certain owners of property. The laws also require regulated lending institutions to ensure that flood insurance is purchased in connection with loans secured by such properties located in areas having special flood hazards.

The agencies believe that the congressional intent of Biggert-Waters was to spur a private flood insurance market. Under Biggert-Waters, lenders must accept in satisfaction of the mandatory purchase requirement policies issued by private insurers to satisfy the requirements of the Act.

In October of 2013, the agencies previously issued a proposal addressing flood issues focused on private but also focused on several other topics related to Biggert-Waters. Based on the response that we received, we thought it was best to reissue a proposal, which is what we did on Monday, to solicit additional comment.

One of the key issues, actually, that was raised through that 2013 process was related to concerns about how you verify that the private policy actually meets all of the requirements and the challenges around the verification. Public commenters noted that few lenders have the capacity to determine whether private flood insurance policies meet all the requirements.

After consideration of the comments, the agencies included in the new proposal a compliance aid, and it's a special provision that assists consumers and lenders in determining whether and how a policy actually meets the private flood insurance requirements. The compliance aid would allow an insurance company to self-identify that its policy complies with private flood insurance requirements and then the lender would be required to accept that policy pursuant to Biggert-Waters.

Private flood insurance policies are often lengthy, and they are complicated, and they require a certain amount of due diligence from banks, and so that is important to remember. In developing the proposal, the agencies worked to mitigate such challenges.

The agencies believe that the compliance aid would assist a lender in reviewing flood insurance policy for compliance purposes. So, for example, the compliance aid would include an insurance company's written summary demonstrating how the policy meets the private flood insurance requirements. And essentially the insurance company would have to tie the requirements to specific provisions in the policy, which we think will be helpful for particularly community banks.

In addition to addressing private flood insurance policies that a lender must accept pursuant to Biggert-Waters, the proposal also expressly permits a lender to exercise discretion to accept other flood insurance policies issued by private insurers. The discretionary exception provisions would provide lenders with flexibility to accept certain policies while also having in place certain safeguards to make sure that both the property and the owner are protected going forward.

One final portion of the proposal focuses on mutual aid societies. The proposal includes an exception that would allow, on a case-by-case basis, a lender to accept coverage provided by a mutual aid society such as an Amish Aid Plan. These plans are sometimes offered to members of religious communities who do not purchase insurance from traditional insurance companies.

That is a topic that came up through public comments. It is not something that we see very often, but the agencies thought it needed to be addressed because there would be questions going forward whether, for example, Amish aid policies would be consistent with the requirements of Biggert-Waters, so an exception was created in the proposal.

I now want to update you on our work on the interagency consumer compliance ratings. For those of you that were at the July meeting, you might recall that in May the agency issued a new proposal focused on revising consumer compliance ratings. That proposal was issued in recognition of the significant changes that have been made in both supervision as well as the banking industry since we adopted the original ratings back in 1980. So we thought it was important to focus on that.

The rating system, of course, is used by examiners to evaluate banks' adherence to the consumer compliance laws and regulations. Based on their review, of course, they assign a rating to each financial institution.

The revisions proposed in May would more fully align our rating system with the way we actually examine today. And as those ratings are being developed, there is no new expectation of higher responsibilities for institutions.

Since the public comment period ended last July, we have been really working in earnest to get the proposal completed by the end of the year. I think some good work has been done. We are really close to releasing it, and I'm confident you will see it soon. But I just wanted to give you an update on where we are on that.

And, finally, I wanted to also talk a little bit about our work on the Military Lending Act. We have been doing some implementation work. We know that that is a new rule that just became effective in October, and so we wanted to make sure that we were providing some technical assistance and information wherever we could.

And, of course, the rule was issued by DoD in July of 2015, and it expanded financial protections provided to service members and their family. It also addresses a wider range of credit products that fell outside of the scope of the preexisting rule, the rule to finance consumer credit consistent with credit that is subject to truth in lending requirements, so much broader than the previous definition.

The MLA caps military annual percentage rates on covered transactions at 36 percent. There are other requirements. But also, importantly, there is a safe harbor, and so under the rule it grants lenders a safe harbor for the purpose of verifying eligibility of service members and their family.

The safe harbor applies if a bank uses either or both of the following two verification methods, one that is administered through DoD -- you might be familiar with their MLA data baseline -- or/and consumer reports from a nationwide credit reporting agency.

And, again, related to the work that we have been doing, on October 17th of 2016, we issued a financial institution letter, FIL-65-2016, announcing the release of interagency MLA examination procedures, which obviously we worked on collectively with the agency as to ensure that we are working consistently as we examine our institutions.

FDIC examiners will use these procedures to evaluate banks' compliance with the rule. Also, the procedures hopefully will be of assistance to institutions that want to have a better sense of the kind of things that our examiners will be looking at as they are in your bank. So those things -- those are out in the public realm and in our compliance manual, which also is on our website.

And also, in these materials, we noted that during early examinations examiners will evaluate banks' compliance management systems and overall efforts to come into compliance. Examiners will consider banks' implementation plans, including actions taken to update policies, procedures, and processes, its training of appropriate staff, and its handling of early implementation challenges.

You know, our examiners understand that this is a new rule. There are some complications around verification and other issues, and they will be mindful of that as they exam for MLA going forward.

In closing, I just wanted to mention we have a number of resources that we are making available between now and the end of the year, in cooperation with other agencies, so we've got some webinars scheduled. One is being held next week. It is focused on overdraft topics, overdraft requirements, and best practices.

And we issued a FIL announcing it. The FIL was on October 17th, but also in 66-2016. So if you have compliance officers that want to hear from the agencies on overdrafts, please tune in to the November 9th webinar next week.

We also have scheduled a webinar for November 29th focused on NCRA Qs and As that the agency issued last summer. I think it was July that we issued them. And also, on December 1st at 3:00 p.m., there will be an interagency webinar focused on the MLA requirements.

In terms of the CRA and the MLA webinars, which will be taking place, we haven't publicly announced those yet, but a FIL will be issued soon with the date and time and particulars on those.

So with that, that's my summary on the things that are going on in the policy area.

MR. PEARCE: Great. So we welcome any feedback on either the work that we're doing on the affordable mortgage lending guide and efforts to support community banks and serving their customers in that area, or any questions related to the consumer compliance update. As usual, there is plenty going on there. If you have any questions related to that, happy to entertain them.

MEMBER HOWARD: I just have a clarification question for Luke. The Military Lending Act, the statement of applicability to institutions under a billion, is there a difference between the requirements for institutions over a billion?

MR. BROWN: No, not that I'm aware of.

MR. PEARCE: So you re probably referring to when -- as part of our community banking initiative of several years back, when we issue -- in the financial institution letter, we put a specific statement as to whether it applies to institutions below $1 billion in assets, so in case there are some differences we are able to articulate them there.

MEMBER HOWARD: So there are no differences.

MEMBER HARTINGS: I had a question on flood insurance. Like many banks, we have very few flood policies. So if someone comes to us and they've got a private insurer, where is the best place to go for that resource, the information you were talking about, the checklist? Because we may have one a year or one every other year. Where would we go as a community banker?

MR. BROWN: Well, first of all, it's a proposal, which we just issued, and hopefully it becomes final and then it will be in place. So if it becomes final, as we articulated, there -- the rule itself has very specific information. And so the way it is set up, the insurance company would be responsible for including basically on top of the policy a statement that says, "Here are the statutory requirements, here are the main components of this policy, and here is how they are all consistent." And then the bank will take that information and they can rely on it and know that it complies.

But, also, I think the -- I'm forgetting the name of the national flood insurance association. I think that they probably would be a helpful resource to you all as part of this process. But, again, this is a proposal, and we think this particular proposal actually will be very helpful in terms of the kind of concerns you are raising, because private insurance policies can be different depending on what they are covering, obviously.

MR. PEARCE: And just to follow up a little bit, you know, this a little bit of an unusual statute in that it requires banks under certain circumstances to accept a private flood insurance policy if it meets the definition. Meeting the definition is not something that was intuitively obvious to folks that are not in the insurance industry.

And so we worked with other agencies and spent a lot of time to try to develop a process by which it would be simpler for a community banker in particular to be able to identify on the very beginning, the cover sheet of the policy, hey, here are the requirements under the statute, and here is the provision in the insurance policy that you can look to that will say, yes, this meets that one, this meets that one. So you would have more comfort taking those policies in that situation.

MEMBER HOWARD: Okay. That's great. Thank you.

MEMBER DAKRI: Just to follow up on that, the certifications that are from the insurance issuer, we would be -- are we going to be able to verify --

MR. BROWN: That's a good question. It's a presumption, but it's not a safe harbor, because ultimately the bank is responsible. But based on the way the statute is written, it can't be a safe harbor, but we tried to put a process in place to protect the bank. But we do believe that since the bank would be relying on the insurance company, the bank could have an action against the insurance company if it wasn't consistent.

I'm trying to make it as easy as possible within the parameters of the statute that we have to work with.

MEMBER THOMPSON: Mark, the technical videos are always so good. Is there any plans for one on MLA?

MR. PEARCE: Well, there might be now.

(Laughter.)

MR. BROWN: Actually, we have been talking about our agenda for 2017 and what would be a good topic to cover. Quite frankly, also, one thing that we consider as we develop our videos is if there are other resources out there. MLA is unique in that it's Dodd-Frank. Sometimes we look to the CFPB to see what resource there are out there. If it makes sense, certainly we will seriously consider it.

MR. PEARCE: Yes. You know, as Doreen mentioned earlier in our community banking update, we have a committee which Luke services on that is reviewing the videos as we try to come up with our agenda for next year. And MLA has been one that I know has been bandied around a little bit, and we'll see whether that one makes the cut or not.

MS. RYAN: Well, any other comments? If not, thank you, Janet, Mark, and Luke.

So we're going to break for lunch now.

CHAIRMAN GRUENBERG: We are ahead of schedule. That's great.

MS. RYAN: And so I think we'll reconvene around 1:00, 1:15-ish. Thanks.

(Whereupon, the above-entitled matter went off the record at 11:41 a.m. and resumed at 1:15 p.m.)

MS. EBERLEY: All right. I think we're ready to kick off our next session.

We are going to be covering some developments in the risk management policy area, and presenting this afternoon will be Rae-Ann Miller, who is the Associate Director for Policy here in Washington, and Shannon Beattie, who is a Section Chief in our Accounting and Disclosure Unit.

So, Rae-Ann, I will turn it over to you to kick us off.

MS. MILLER: Thanks very much. I'm

going to talk first about some guidance we issued over the summer on proposed third party lending guidance. We issued this for public comment back in July of this year under Financial Institution Letter 50-2016. And we welcomed comments on all aspects of the proposal but asked 10 specific questions in that release, focusing on scope of the guidance, the risks we enumerated in there, risk management programs, and supervisory and examination considerations.

So the proposed guidance provides information on third party lending and supplements the longstanding safety and soundness in consumer compliance principles that were addressed in the guidance for managing third party risk. That was issued in 2008 under Financial Institution Letter 44-2008. I do remember that one, by memory, which I referred to as the 2008 guidance.

And also with the 2008 guidance the proposed guidance indicates that a bank's board and senior management are ultimately responsible for managing third party arrangements as if the activity were handled within the bank. The proposed guidance goes on to point out that managing and controlling risks can be challenging when origination volumes are significant or there are numerous third party relationships involved.

The proposed guidance defines third party lending as, and I'm going to quote, "a lending arrangement that relies on a third party to perform a significant aspect of the lending process." And we talk about three different ways that a third party arrangement might be covered by the guidance.

And the first is originating loans through third parties. And, for example, here we mean arrangements where institutions partner with an entity that lacks the necessary licenses or charter to lend on its own behalf in various states. Then we talk about originating loans through third party lenders jointly with third party lenders, and what we mean there are -- for example, are agent relationships in which the institution authorizes the agent to originate loans on its behalf in some situations. You may have many hundreds or thousands of these agents.

And the third way is using platforms developed by third parties, and the example here would be so-called white label lending products in which the third party provides sort of an end-to-end platform and service for the institution.

The proposed guidance does not single out any particular type of third party lending arrangement. But regardless of the particular type of third party lending relationship, institutions that rely on a third party to perform a significant aspect of the lending process are expected to have a robust risk management framework in place to address the associated risks.

The 2008 guidance provides what was a general framework for implementation of effective third party risk management process, and it was principles-based and also covered third party lending arrangements. But the proposed guidance supplements and expands on those principles by establishing more specific expectations on how those principles should be applied in third party lending activities.

Now, there are several examples of that, but I will give one. The 2008 example, the proposed guidance addresses potential risks and expectations for establishing a risk management process, but the proposed guidance goes into a lot more specificity as those processes relate to lending.

So the proposed guidance also addresses supervisory considerations related to third party relationships, which are consistent with outstanding safety and soundness principles such as Appendix A to Part 364 of the FDIC rules and regulations. And that addresses, among other things, internal controls and information systems and loan documentation credit underwriting asset quality and earnings. And, again, it is not just consistent with Part 364, but also the existing guidance from 2008.

The proposed guidance also talks about that, like any third party relationship, partnering with third party lenders does not relieve the institution from adherence to safe and sound banking practices, and compliance with applicable laws and regulations, and those include consumer protection and fair lending requirements, it includes Bank Secrecy Act and anti-money laundering requirements, and as well as requirements to safeguard customer information.

Consistent with existing practices, the proposed guidance also indicates that institutions engaging in significant lending activities through third parties will generally receive increased supervisory attention. The proposed guidance states that arrangements will be considered significant if, for example, they have a material impact on revenues, earnings -- revenues, expenses, or capital, involve large lending volumes in relation to the bank's balance sheet, or involve multiple third parties, or present material risk of consumer harm.

The comment period just closed last week on October 27th. So far we have received 28 comment letters. I've got a call that I have one more coming. We're in the process of reviewing those letters, and certainly we will consider all of those issues as we move to finalize the guidance. We have those letters publicly posted on our website for those who are interested.

Doreen, save questions for the end, or do you want to --

MS. EBERLEY: Sure. Is that okay?

MS. MILLER: Okay. I'll do a quick EGRPRA update. So I'm going to provide you with a quick EGRPRA update. And for those of you who haven't heard before, EGRPRA -- it's called the Economic Growth and Military Paperwork Reduction Act of 1996 -- requires that the banking agencies and the FFIEC review their regulations at least once every 10 years. And the purpose is to identify outdated or unnecessary regulations and to consider how to reduce regulatory burden on insured depository institutions, while at the same time ensuring their safety and soundless and that of the financial system.

The agencies are also required to categorize and publish the regulations for requirement and to submit a report to Congress that summarizes any significant issues that are raised by the commenters, and the relative merits of those issues.

So the agency has received over 250 written comments from the four Federal Register notices that we did, and we have numerous comments from the -- over 1,000 participants in our outreach sessions. And we did six and I recognize some faces and talked to a bunch of you during that.

There are six areas that received the most comment in that process, and those were the examination cycle, issues around appraisals and evaluations, call reports, comments on Bank Secrecy Act and anti-money laundering laws, the Community Reinvestment Act, and issues around capital.

So we continue to review those comments on all of the areas, but I wanted to touch on a few where we have already taken some action. So with regard to the examination cycle following legislation earlier this year, the FDIC issued an interim final rule to make the 18-month examination cycle available to more community banks by increasingly eligible threshold for well-rated and well-managed institutions from 500 million in total assets up to one billion.

The FDIC board approved a final rule adopting this change on October 19th. With respect to appraisals and evaluations, so directly responding to issues raised by a group of commenters, particularly those in the rural outreach sessions, the agencies issued an interagency advisory on use of evaluations in real estate-related transactions, and that was in March of 2006 through FIL 16-2016.

This advisory talks about existing supervisory expectations, guidance, and industry practice for using evaluations instead of appraisals when that is appropriate and authorized under the regulations.

And with respect to call reports, I am

going to turn it over to Shannon in just a second, and she is going to talk more specifically about the call report efforts. We got a number of comments on BSA, particularly relating to the statutory thresholds that are contained within those regulations, their statutory thresholds. And we have shared those comments with the financial crimes enforcement network who are the purveyors of those regulations.

So -- and capital. And capital. To assist bankers in complying with the revised capital rules, the FDIC-conducted outreach and technical assistance, and that was designed to -- specifically for community banks. We published a community bank guide, released an informational video, and conducted a number of face-to-face banker information sessions in each of the six regions to discuss the revised rules most applicable to community banks.

And, also, under the major areas, it was also our intention to continue to look for ways to reduce or eliminate outdated or unnecessary requirements. One of the themes was, wherever there is paper, maybe we can reduce some paper. Since the committee last convened, the FDIC announced a program just last week that will allow insured institutions to voluntarily file audit reports that are required under Part 363 electronically through the FDIC Connect system, and we communicated that through FIL 71-2016.

So, as I mentioned earlier, we received a number of comments. We are still reviewing those and still looking for ways where we can take action. So we're getting ready to conclude the EGRPRA process very soon, and my expectation is, you know, we will issue our report shortly thereafter.

And I'm going to turn it over to Shannon now to talk a little bit more about the call report efforts.

MS. BEATTIE: Thank you. Good afternoon. I'm going to talk a little bit about the call report with specific emphasis on the call report for small institutions. And so in your materials you do have the press release from the

FFIEC dated August of this year.

So the FDIC and the other banking agencies continue to move forward with the FFIEC's community bank call report burden reduction initiative. Previously, Chief Accountant Robert Storch has spoken to the advisory committee about the five action areas that comprise this initiative, and I am going to focus on our more recent milestones.

So the FFIEC did reach a significant milestone in this initiative in August when it announced the issuance and invited comment on the proposal for the new streamlined call report for small -- eligible small institutions, and those are institutions with domestic offices only and less than $1 billion in total assets.

These eligible small institutions represent about 88 percent of all insured institutions. The proposed new report, which is designated as the FFIEC 051, is intended to ease reporting requirements and reduce reporting burden for small institutions. The overall proposal also includes certain proposed burden reduction revisions to the other two existing call report forms. That would be FFIEC 031 for institutions with domestic and foreign offices, and the FFIEC 041, which is for institutions with domestic offices only.

The new FFIEC 051 call report, and the revisions to the other two existing call reports, are proposed to be implemented as of March 31, 2017, that report date.

The existing 041 report served as the starting point for developing the proposed 051 report for the smaller institutions. The changes have been made to the 041 call report to create the 051 call report, which reduces the length of the call report and removes a significant number of the data items currently included in the 041 call report.

These changes also include the addition of a supplemental schedule containing indicator questions on certain complex and specialized activities such as derivatives, the use of the fair value option, and the servicing, securitization, and sale activities. The supplemental schedule provides a basis for removing all or part of six schedules and other data items that currently exist in the 041 report.

Other changes made to the 041 call report to arrive at the 051 call report reflect the elimination of other data items and the reduction in the frequency of data collection for data items that were identified during the regulatory reviews of the existing call report, and these were determined to be no longer necessary for collection from small eligible -- eligible small institutions.

The proposed 051 also removes all of the data items for which a $1 billion asset size reporting threshold existed. In addition to the efforts already made, the agencies plan to prepare a separate shorter call report instruction booklet for the FFIEC 051 report.

The proposal also notes that eligible small institutions would have the option to file the 041 call report rather than the 051 to allow timing for transition. So, as I mentioned, the 051 is expected to be -- well, it was proposed to be effective for March 31, 2017, but institutions could opt to continue to use the 041 as long as they needed to.

For a small institution otherwise eligible to file the 051, the institution's primary federal regulatory agency, jointly with any state chartering authority, may require the institution to file the 041 instead based on supervisory needs, which would consider criteria including, but not limited to, whether the eligible institution is significantly engaged in complex, specialized, or high-risk activities.

The agency anticipates requiring individual small institutions to file the 041 report in only a limited number of cases. And to ensure this outcome, policy guidance will need to be developed to ensure a fair and consistent process for identifying institutions that should file the 041 rather than the 051.

As noted in the Federal Register notice for the proposal, the FFIEC and the agencies are committed to exploring whether the eligibility to file the 051 can be expanded to additional institutions beyond those with domestic offices only, and less than $1 billion in total assets.

The deadline for submitting comments on the proposal was October 14th of this year, 2016. The FFIEC and the other banking agencies are currently reviewing the comments received and determining how to proceed with the proposal.

There are also additional efforts to reduce the call report burden for small institutions that remain to be taken under the FFIEC's community bank call report burden reduction initiative. Supporting these efforts are the ongoing survey of call report data users from the member agencies, from the FFIEC member entities that use the call report.

Based on the result of these surveys, the agencies are identifying additional call report data items that are considered for elimination, less frequent collection, or a new or upwardly revised threshold limit. The results from these remaining surveys will be incorporated into call report proposals that are planned to be published for comment in 2017, and the call report revisions from these proposals would have a targeted effective date of March 31, 2018.

And that concludes my prepared remarks.

MS. EBERLEY: Okay. So we will open it up for discussion. I might start by saying the surveys, we have really taken a different approach with this than traditionally. Whenever a new item is added to the call report, there is a very robust vetting process. And through the surveys, we are actually using that same vetting process for every single existing line item. So going to the data users and defending the need for the data line by line, schedule by schedule.

So that effort will continue on and would be expected to result in additional eliminations next year, as Shannon said.

MEMBER HOWARD: So there was -- as a

result of the FASB ruling for banks that have equity portfolios, I think it is 2019 or 2021 when it goes into effect where you have to run changes in the portfolio through your income statement versus your balance sheet through capital.

There was some discussion about having that -- the results of those changes in that portfolio communicated in the call report kind of at a place in the call report where it would help a reader to understand the changes in the income statement. Has there been any progress on that? Is that included in what is being proposed?

MS. BEATTIE: That issue -- and that deals specifically with equity securities.

MEMBER HOWARD: Right.

MS. BEATTIE: And I am aware of that feedback that we have received for the --

MS. EBERLEY: And it is still in the queue. So the way that the task force on reports that works on the call reports has positioned its workflow was to get the reduced content call report form out first, then go through the rest of the line items. And given the fact that we have still got some time before that ruling goes into effect, that is a little further along in the workflow, but that is on the list of changes to be made and we had made a commitment to do that.

MEMBER HARTINGS: Just -- and I applaud your efforts to reduce that call report burden. Just from high-level numbers of pages, you know, the old call report was about 80 pages, and 380 pages of instructions. What does the 051 call report look like, in number of pages and number of pages of instructions?

MS. BEATTIE: So the 051 call report will reduce from the 81 pages down to 65 pages, and we are in the process of reducing the call report instruction book. So I don't have page numbers to give you on that right now, but certainly those instructions related to the schedules that have been removed will comprise a good portion of the instructions that are removed.

MEMBER HARTINGS: Super. Thank you.

MEMBER BAER PAINE: Just a comment, and

I know that you're still working on the process, but everybody that I have talked to that is taking a look at the changes feel like it is going to be a net zero time savings effect, some of which obviously, if they're between that 50 and 300, in that zone, just a suggestion, when you're looking at things and you say, "We need to gather this information quarterly," while we're going to go semi-annually, unless it's annually it's not too much of a time savings, and so we will maybe consider that.

And then you're replacing one number with four questions, you're actually adding some more, so -- in some specific questions, you know, yes, noes, are easier. It's not a number, but it was just one number to begin with. So just on some of those things, and maybe when you're visiting, feel free to call any of us at any time and see how easy it is to compile some of the information, and other information I'm sure you do that already.

MS. MILLER: Well, we actually did that as part of this process. We sat with nine institutions and actually watched them prepare the call report. I mean, not like standing over their shoulder, but I'm sure spoke with them during a couple of days, and Bob Storch, our Chief Accountant, participated in that.

All call report changes are put out for comment. We did get a lot of comments on this one, but in past years very few people ever commented on call report changes. So it's really helpful to hear your comments. And as Shannon mentioned, this is not the last of the changes, and we will put the future ones out for comment as well, so, you know, really appreciate the comments and want to have you as part of this process.

MEMBER HOWARD: You mentioned that under consideration would be the 051 for banks larger than $1 billion. Do you have a sense of a time frame and are you looking at like maybe larger than $5 billion or?

MS. EBERLEY: And, I don't have a response for that at that point.

MEMBER HOWARD: Well, 4.5.

MEMBER DAKRI: Going into the group updates, you had been sharing that, say, Ms. Adams, for example, USA is really a FinCEN in issue.

So, is that basically FDIC's kind of like, well, we'll get on the FinCEN everyone's supposed to do, is that where we stand on that in terms of CTRs and things of that nature?

MS. EBERLEY: So, statutorily, we're required to --

MEMBER DAKRI: Is there any ration?

MS. EBERLEY: Absolutely, all the time.

And, as a matter of fact, last year, we have FinCEN come to the committee, it might have been April of this year, but I think it was last fall. FinCEN came and did a presentation about the use of the data and it was very informative, including pointing out that three of our members of our Advisory Committee had filed a SAR or a CTR that had led to law enforcement action.

Three of the members, they didn't say who, they said they had to protect the identity of the institutions. But, that the information is absolutely used and fruitful in terms of stopping terrorist financing and money laundering.

We have encouraged them to spread the word more widely, you know, and really do some publication of that. It was a very compelling presentation that we had. And, I'd encourage you to go back and take a look at it. It's still available on the webcast.

But we did share the comments with them and hope that we'll have some response.

MEMBER BEARD: I agree, you ought to publish that because there's, at least in our neck of the woods, a feeling that it's done, but who knows what happens to and is it of any value.

MEMBER HOWARD: I can just comment. I'm not in Utah, I'm Connecticut and we have probably a pretty aggressive program in filing the SARs. The locally enforcing office that receives information from the SARs that's communicated to us on a few occasions, how helpful it has been in their efforts to fight terrorism.

And, to initially, had a perspective that, gee, it seemed like all of these filings were, you know, all of these SARs are being filed and there didn't seem to be much happening with it.

My sense is that it takes a long time to build these, you know, these cases with lots of information from lots of sources.

But, the, you know, the money source is a critical piece of it.

CHAIRMAN GRUENBERG: Doreen, can I ask, with the recent situation, in a previous meeting, and since we have some in here who are members of the committee.

Yesterday, I met with banking groups, questions about the new CECL standards coming through frequently, I thought maybe we'd spend just a minute on that and see if there might be any questions.

MS. EBERLEY: Sure.

We did conduct this as part of our ongoing initiatives for community banking, a webinar with the Independent Community Bankers

Association back in August, I believe.

And, we reached out to the American Bankers Association to conduct a webinar with them as well.

And, the agencies have on an interagency basis issued a first piece of guidance kind of outlining what the requirements are.

The work is ongoing with the agencies. Shannon, I don't know if you can provide more detail about where we are in the process and what might be next?

MS. BEATTIE: Sure.

So, the next effort that the agencies are coordinating with, and so that would be the Federal Banking regulatory agencies are coordinating with some Frequently Asked Questions that we hope to publish before the end of the year.

MS. EBERLEY: But, are there any specific comments or things you want us to be thinking about as we're doing this or questions that you would want answered?

MEMBER HARTINGS: You know, I think a

lot of us are looking at the information we're going to need to gather. You know, most of us are -- we'd be late adopters as 2020 of '21, whenever that is.

But, we want to get prepared for that. So, any of that -- any information you can put out that would be statistical information we're going to have gather to start building systems.

And, then, do you also coordinate that with our major core providers out there? Because, of course, they're probably going to have build something to create some of that information.

Have you communicated with them at all?

MS. BEATTIE: On an interagency basis, we have met with some of the service providers to get an idea of what services they would offer and what data points they would be looking for.

MEMBER HARTINGS; And, have any ideas that they say that's possible? There's -- is this an ongoing dialogue with that? Or, that's a major hurdle that they're going to have gather that information? Or, bankers are going to have to supply to them in a different manner, I guess?

MS. BEATTIE: The conversations are in the early stages of digesting the standard and what the potential requirements are.

I think one conclusion coming out of that is, because institutions can chose what model is appropriate for their individual loan portfolios, that it's going to depend on what type of model will be used and that will drive what data is needed.

So, I think one way of putting it was, it's going to be an iterative process as an institution decides what model they're going to use for a particular portfolio, that's going to drive what data points are needed. And, probably some back and forth to figure out what's going to be the appropriate models to be using.

MS. MILLER: And, to your point, Jack, you know, we're still digesting it, too, and what all needs to be done. And, so, coming up with a plan for that on an interagency basis and adjusting and doing things as we get feedback is going to be a huge, huge job.

And, everybody's got a lot of questions, including us. So, we recognize that we need to get information out there as early as possible. That's what those calls were about. That's what the FAQs are about.

And, as we, you know, develop more guidance around, you know, what our expectations are, because that's what you guys need to know and that's what the core providers need to know, the, you know, those discussions start to heat up.

MEMBER HARTINGS: How does that work within our external auditors? Because, again, they're probably another piece of that that's going to be very important that everybody's on the same page.

MS. BEATTIE: Right. And, likewise, we've been reaching out to the audit firms as well to talk about some of the challenges and obstacles with the standard.

And, I think the conversation's going to include just the parties you've mentioned, the external service providers, the auditors, an even within institutions, more than just the accounting staff, but the loan staff as well and IT staff.

MEMBER HARTINGS: Will you be providing a model?

MS. BEATTIE: There's no intention at this point.

MS. EBERLEY: Our guidance will, though, discuss the options that you have available which are basically the options you have available now.

And, you know, I think from what I've heard in outreach sessions, what would be helpful that we may be able to do is talk about what kinds of data you would need, depending on the model that you pick and have conversations with technology service providers about the availability of that data on a historical basis. Is it in their systems? You know, is it something that could be available to you?

MEMBER HARTINGS: And any help you can do, I mean, because it's kind of a discovery stage right now. We're trying to get to that point.

MEMBER HANRAHAN: Doreen, do we know about the dangers at this point? That I'm reminded of other subjects FDIC has commented, you don't need the hierarchy stuff to necessarily to do --

So, if I run a pretty simple non-complex shop and I want to track losses by call report code or something like that, would the FDIC stand by that sort of comment on this subject that, if I can build an Excel spreadsheet that adequately tracks those data points, might that be sufficient?

MS. EBERLEY: Yes, the system is meant to be -- the proposal is meant to be scalable just as you are describing.

MEMBER HANRAHAN: Thank you.

MEMBER BOEKA: You know, there is a side in the industry here developing them to the limit. And, I kind of already count five groups that are viewing this as an income source, including the core providers also.

MS. EBERLEY: That will increase once --

MEMBER BOEKA: Do then give you that

out whatever it is, it'll be an extra charge. I mean that's what you've already said.

CHAIRMAN GRUENBERG: Clearly, we'll do everything we can to provide technical assistance and support to implement the new rule and there are genuine expectations that this is something community institutions can handle.

And, elaborate new models and hopefully without reliance -- necessary reliance on outside consultants.

But, I would suggest that going forward we have the -- devoting a lot of attention to this. And, as you go through the process of coming to terms with it for your own institution and how you're implementing it, I really do suggest you engage with us and your examiner on how you're approaching it so that, if we can -- if you can get a sense from us that you're on the right track, that may be a way for you to make informed judgments within, with additional assistance or not.

So, I think we would like to try to be helpful in that regard. And, there's certainly no expectation in order to know what you should have utilize a third-party on there.

And, thank you.

MEMBER TURNER: Did the banking agencies coordinate with the Office of Chief Accountant at the SEC as well?

MS. EBERLEY: Yes.

MEMBER TURNER: That's good.

I think allowance, guidance, not just by the regulatory authority, but you ask you accountant, especially on the as FAS five allowance. I think it's extremely confusing.

I've found that nobody can really clearly state how your FAS five allowance should be calculated.

So, I think if you could step back and just, censure a clear succinct statement under CECL, here's what we're really talking about. I think that would be extremely helpful.

MEMBER DAKRI: Do you have any indication from your own -- kind of got a feeling which you think that that will be going up or down, the allowances with the CECL coming out?

Is there a gut feeling from the FDIC saying we expect institutions to move down from where they are today, or is it going to make a deduction allowances? We're going to make allowances go up? Is there --

MS. EBERLEY: Yes, mathematically, you would expect it to go up. And, that's because you're going to be reserving for the life of the loan. And, under the current incurred loss model, you're looking at losses you expect to incur in the next 12 months.

So, unless your loan book is on a 12-month, you know, duration, that's not what you would -- you would expect to see some increase.

MS. MILLER: Mathematically, but we haven't done those calculations. That's just conceptual.

MEMBER BOEKA: But, installing the COLR report, your rate is in the allowances.

MS. EBERLEY: A few minutes ahead of schedule.

So, now, we're ready for a roundtable discussion. All right.

So, this will be the first time that we've held a session like this where we wanted to just open it up and I think it's a good time since we have new members.

Just, what kind of things would you like to talk about today or in future sessions? How might we be most helpful through this process?

MEMBER BEARD: Can I ask a question and I don't know quite how to ask this artfully, but with all of the bad publicity that the banks have been getting again because of this Wells situation, is there a sense from the FDIC of how the response from the regulated side is going to be?

In other words, are there new rules that are being thought about? New concerns that we need to be aware of at our level that might flow down from that kind of behavior and those things that seem to be happening out there in the world?

MS. EBERLEY: So, there's no plan at this point for new rules or new procedures. We have not changed our guidance to our examiners.

We have incentive compensation guidance out already in the form of a Statement of Policy that's interagency that addresses the issues that have been talked about.

It addresses the need to balance risk versus reward. It addresses volume-based compensation.

So, those fundamentals have been built in to our exam program. So, no changes expected there.

I think it's fair to say that there are a number of members of the industry that are, you know, doing some introspective looking right now and looking at their practices and making sure that they don't have incentives that could lead to unintentional consequences.

And, there is some review work going on on an interagency basis to take a look at larger institutions.

MEMBER BEARD: Thank you.

MEMBER HARTINGS: Just a couple of

items. We talked about CECL. We talked about the call report. Yes, I think those items would make sense to have on our agenda the next couple of meetings simply because of that.

It's a real dynamic with a lot of changing and a lot of moving parts. You're adding pieces to that.

The other item that we didn't have up in this -- is not on our agenda this meeting is the CAT tool. And, it'd be interesting to know like if you have a sense of the acceptance and, oh, what do I want to say, how many have implemented it?

You know, like I know at our institution, we've implemented it. We've gone through the basic and I don't know all the categories, but we're into the second category and third category now answering all those questions.

Do you have sense of how the industry has adopted that on the CAT tool?

MS. EBERLEY: Anecdotally, so we're not counting, but anecdotally, I can tell you, and we do talk about this at the Federal Financial

Institution Examination Counsel test for some supervision meetings. So, that's the group that developed the cybersecurity assessment tool and will continue to update it over time.

And, anecdotally, it was, matter of fact, we talked about it this past week, what we're hearing is that it's been well received. We have gotten some comments about how it can be made more useful.

And, we're working on some slight changes that we think will be helpful to the industry for this year.

And, then, some time next year, we'll take a look and see, you know, maybe an update.

One of the things that we hear regularly, and we really do pay attention to is, you know, something stands still and not keep changing, you know. So, we want to be mindful of that and not change it too often. But, we also want to make sure that the tool remains useful in a really rapidly changing environment.

So, as threats change, as technologies

advance, we want to make sure that we keep the tool up to date.

So, you know, maybe every couple years or so we would update and that would be an opportunity for industry to give us some feedback as well.

We participated in a meeting that was sponsored by and hosted by the National Institute for Standards in Technology (NIST) and they allowed us to have a session during their meeting where we had a focus group, basically, with the industry.

And, so, we heard some comments that we'd heard before, got some additional feedback. But, again, by and large, the feedback was very positive.

One of the things that came out at our mutual banker forum back in August, I thought, was a great comment. There were discussion about using the tool to facilitate Board discussion and understanding of the institutions' technology department and the risks and, you know, how does it all work?

But using the tool and walking through the inherent risk profile and the maturity levels and where the institution was and if there was aspiration to be somewhere else, you know, how would you get there?

But, actually using the tool to facilitate that discussion. I thought that was a great best practice that was shared.

MEMBER HOWARD: But, we're not sure the -- I think we were fairly early adopters of the tool and that, you know, the four-step process that's included in the entire assessment.

And, what we found is that, the more conversation, the better. And, this is probably one area where if things need to change, we would -- we, I think, all of us could benefit from having, you know, having that knowledge sooner rather than later because of the obvious level of risk.

But, it has been a great tool for us to have the discussion with our Board just to explain what it is. But, then, as you go through the discussion around the steps and the conversation around where we believe we are as an institution, we found that to be very helpful.

We're kind of establishing why we are where we are and what it will take to get us to level two or beyond.

ME. EBERLEY: To your comment about just having the conversation and really being transparent about what needs to happen.

Earlier this year, I believe it was in July, we issued our new examination work program for information technology. We're calling it InTREx which is Information Technology Risk Examination.

And, we changed our approach so the work program is public. But, the piece of our approach that we changed is, we redesigned the work program around the four components of the information technology rating.

And, we're going to start disclosing those component ratings. That's something we had not done before. But, that'll make it, we think, you know, much more clear about where do we think, if there's a concern, it'll be reflected in the rating. You'll know exactly which section to focus on.

You've got the work program of how the examiner is evaluating it. It ties, of course, to the FFIEC information technology handbook and the underlying booklets. So, it's all very well aligned.

We also flagged in the work program all those areas that align with the baseline standards in the cybersecurity assessment tool. So, you can see where that flows into an examination assessment.

The risk assessment is something you have to do. The tool is one thing to help you do it. But, try to just create a line between all of these things.

MEMBER HARTINGS: And, one of the questions goes back to Richard's question about Wells a little bit.

And maybe Mark can answer this or Doreen, I'm not sure.

Do you see an issue in the community banking world, the abuse of cross sell or even the prevalence of a lot of incentive compensation to incentivize workers on the floor to cross sell to bring products to increase that for a major compensation benefit. Is that something that you actually see out there in a community banking examination?

MS. EBERLEY: Not a lot from the questions we've asked of our regional directors recently. And, like, what kind of activity would you be seeing? So, not a lot of that. I know that's as far as we've gotten in terms of looking into that any deeper, but that's the anecdotal.

MEMBER HARTINGS: Well, yes, the concern as a community banker is, you know, I don't want to pay the price for that because I don't, you know, that's not the way we do it in our shop and that's not the way we would do it in our shop.

So, I just -- from a regulator's observation, do observations considered to be a little bit more objective than, you know, calling my bank or another bank.

So, anything that you can communicate on that side of it, I think, especially in a community banking world would be important to our regulators and our legislators, I'm sorry, legislators. I just think kind of keep that in mind, it's good for us, too.

CHAIRMAN GRUENBERG: I think it's fair to -- oh, did you want to -- I think it's fair to say that, you know, there will be follow-up and attention to the issue that there have been previously the focus here is community banks.

We will be looking at larger institutions. There's been that there's not an initial thought that probably this is a community bank issue at the onset. Is that fair to say, Doreen?

MS. EBERLEY: Yes.

MR. PEARCE: And, the only place on the consumer side where we've looked a lot at compensation practices related to mortgage loan originator compensation, there's rules related to how that's connected in terms of loans, but nothing that relates to this kind of situation.

CHAIRMAN GRUENBERG: Thank you.

MEMBER SCULLY: So, there's been some speculation, and we haven't seen it, but we're always right below the level that the scrutiny around CRE concentrations has intensified in the last year.

And, some stories in the industry that, you know, that rather than it being guidance and a requirement that, if you are concentrated, you're expected to have certain information systems and certain expertise resident in the organization, that it's becoming more of a hard line.

And, we've never experienced that. I've always said to people, we've never experienced that if you can show your expertise.

But, we're now hearing stories, and I will say, not all necessarily or not mostly FDIC related but where some of the regulatory agencies are making it a bright line and actually raising capital requirements as a result.

I mean, do you see that? Do you have that concern? I know we're at that point in the cycle perhaps, but --

MS. EBERLEY: Maybe a couple of things.

I can tell you that we work on this matter on an interagency basis, on a regular basis. And, we had some concern last year as we were seeing -- was starting to see some rapid growth in already concentrated portfolios, particularly ADC.

And, also seeing an increase in funding or that activity with wholesale funding.

You know, so, we want to make sure that we're out in front of any problems. And, we did issue guidance in December of last year, an interagency statement, reinforcing the importance of having strong capital and a strong allowance if you are concentrated.

We don't have a prohibition against it and, frankly, community banks are going to be concentrated.

But, you also have a concentration in your geographic market. You don't have a wide dispersion of operations.

So, because you're vulnerable to any changes in your economy and you're going to have that vulnerability on your balance sheet of being concentrated, we have post-crisis.

Reemphasized with our examiners the importance of underwriting and credit administration, including not just your risk management practices paying attention to what's happening in your marketplace, understanding it, having risk limits, having those discussions at the Board, stratifying your portfolio, stress testing your portfolio.

But, also risk mitigation, which is the strong underwriting, having covenants, you know, using covenants. You know, what kind of brave -- what kind of -- and not loosening them as the market's getting frothier, right, you know, that's not the time to -- not doubling down.

So, those have been the kinds of conversations we've been having. I talked earlier this morning about kind of our round of training.

We're on a three-year training cycle and that was a major focus coming out of the crisis and the lessons learned through all of our -- the bank failures.

But, that is the way that we've been approaching it. I believe we're consistent with the other regulators based on the conversations we have with them.

So, if there is a conversation about a need for higher capital, you know, it may be related to weaker underwriting or something particular to that institution.

MEMBER BEARD: I would just maybe follow up on that. Again, in Utah, we may be late, but the credit unions have become dominant factor in Utah.

Our bank, for example, used to do a lot of consumer lending, it's about two percent of our portfolio now. Is there any guidance from the FDIC looking at, it may not be that you want to be concentrated, it may be that you don't have the opportunity to be in other areas.

So, for example, in that consumer area, is there any guidance helping banks to how to deal competitively with -- it's my perception of it of an unbalanced playing field. It is very difficult to attract consumers when they can get the same products for less down the street.

And, so, it forces us into that concentration mode. Any thoughts on that or help that you can give us?

MS. EBERLEY: I think, you know, we've approached it from the other side of saying that that is balance sheets have evolved over time and they have changed over time. And, that's something that's covered in the 2012 community bank study where community banks used to have quite a bit more consumer loans on their books.

And, as that product has kind of been commoditized, there's less of it. And, then, that's left you with more commercial real estate types of loans.

So, you know, from how to increase consumer lending or be more competitive in consumer lending, you talked earlier today about --

MR. PEARCE: Yes, let me jump in a little on that.

I think, you know, obviously, we mentioned earlier a formal mortgage lending guide and some other efforts to sort of present some opportunities for banks to expand what they're doing in the consumer area.

Also, the technical assistance video on the mortgage rules to sort of -- the different side of the same issue of how can we help community banks manage an area of regulatory change and remain in the marketplace?

I think one of the bright spots, as we've been monitoring evolutions in the mortgage market, in particular, you know, a few years ago, there were a lot of concerns around community banks exiting the mortgage space.

And, I think, for the most part, looking at the data broadly, we haven't seen that happen, though. We've seen banks remain in the mortgage market.

And, in fact, community banks increasing their mortgage lending as compared with the larger banks. So, we've actually increase in market share and growth and in community banks as compared to mortgage.

So, maybe a little bit of that's balancing out a little bit and not quite as stark a picture as maybe people had feared.

MEMBER DAKRI: If I could just go back to the concentrations and the ABC loans. Has there been a thought of maybe anyone thought about separating construction loans by kind of occupied constructions, if you will, versus trend speculative construction? Has there been thought to that?

MS. EBERLEY: No, not breaking out speculative construction on the call report. We have not.

You have a little bit of that in terms of the breakdown now, basically, my words are the construction that's vertical and construction as horizontal.

And, the horizontal type is so land development loans, that was the riskier piece during the crisis. And, as expected, I mean, you're probably not pre-sold there.

Whether or not -- we don't usually get asked to add call report items, but that that is something that, if it would be helpful to the industry, you know, that's something that we could contemplate.

MEMBER DAKRI: I think that a lot of community banks, they're probably going to be more on the side of the owner-occupied. But, generally, the customer needs a new warehouse, you're building that, it goes as a construction loan under that --

MS. EBERLEY: Right.

MEMBER DAKRI: -- bucket until it finished and you can flip into the permanent.

MS. EBERLEY: Right.

MEMBER DAKRI: And, those type of things, I know specifically for us, we're over the 100 percent due to that.

MEMBER BAER PAINE: That would apply to us as well. And, so, what we do to mitigate our risk, understanding that we've got concentration in that area, is to take a look at all the net codes and really break them down specifically and understand. Then break out another report that says owner occupied for instance.

And, I'm not asking to add a ton of call report, there is some available data there. But, we have to start tracking because there's concentration in that area.

So, is there a common bond? Is there a single breakout that would help mitigate that risk and then does that tie it into other commercial loans like, you know, like really sensitive and how does it affect those benchmarks if it's not as high risk?

And, it does bleed over into multiple areas. We have to look at that anyway.

MS. EBERLEY: It's part of your risk management practices around your concentration.

MEMBER TOLOMER: And, you might

capture that as you're stratifying your portfolio and you're discussing with the regulators, you can -- I certainly would be a proponent on breaking that out separately.

In terms of multi-family in New York, I know that's always been an issue. Do you see a difference between brokered applications as a -- applications coming from brokers or from the fact that you're dealing with a customer who owns a building?

MS. EBERLEY: I think, you know, that the answer I would give you, there is that when you're dealing with a broker bringing you a loan, you know, you've got to think about the third-party lending and you've still got to do your own due diligence.

MEMBER TOLOMER: Agreed.

MS. EBERLEY: And, so --

MEMBER TOLOMER: But, in terms of the concentration is what I meant. Do you really kind of look at that as a little different?

MS. EBERLEY: No.

MEMBER TOLOMER: How is that different asset class but if you --

MS. EBERLEY: No.

MEMBER TOLOMER: -- it's a little different risk.

MS. EBERLEY: It's a different risk and so, we wouldn't look at the concentration differently. We would look, though, very closely and do look very closely at the due diligence that's done on the brokers, the due diligence that's done on the information provided by the brokers.

You know, so, what kind of validation work is done to make sure that it's accurate.

MEMBER TOLOMER: Right.

MS. EBERLEY: And, that sort of work. And, we absolutely do do that through the exam process.

MEMBER TOLOMER: Okay.

MEMBER HOWARD: In terms of conversations or maybe the appearance at the next meeting, several of my colleagues have talked about the Community Reinvestment Act.

And, you know, obviously, at the time that it was introduced, it was, you know, it was something that was necessary.

But, what we're finding now is extreme difficulty in trying to adhere to -- there's not enough business for all the banks in a particular area to meet the requirements.

And, we're going through what I would consider to be fairly extraordinary means to try to get creative to try to, you know, purchase the loans or something like that where we can't make that because there's not demand.

And, so, if there is an opportunity to have a conversation around, you know, learnings from maybe other parts of the country where other institutions have been successful.

I know certainly in the Northeast, it's a real challenge. You know, in many of the urban areas, there are multi-family properties that are non-owner occupied and, yes, we don't do that kind of lending because of the risk associated with it.

So, if there's a, you know, if there's

a chance to have some conversation around that, I think it would be, certainly in our case, it would be really helpful.

MR. PEARCE: Sure, that's helpful feedback. You know, as part of the EGRPRA process, we have gotten some comments from different stakeholders on Community Reinvestment Act generally.

But, then, sort of understanding how, to your point, it's how are institutions in as the performance context change and the economy changes, how are they able to meet the community needs to their communities for credit?

MEMBER THOMPSON: But we know the community bank forum that was held in April here was, I thought, really good. Is there a plan for that on next year's calendar something of that fashion?

MS. EBERLEY: I think I'm going to defer to the Chairman.

CHAIRMAN GRUENBERG: Yes, we've had questions about that. I think we would like to do it again. Doing it annually, you know, has been a challenge because there's a lot of work that goes into it or I haven't discounted the possibility.

But, certainly on a biannual basis seems to me to be a reasonable thing to do. But, there's a lot that, to every other year if there's enough that's going on in terms of the developments within the community bank industry, and we think it's a basis for hosting that -- a conference like that.

So, I think biannual will put it clearly, I will look at that, it'd be a bit of lift up.

MEMBER MENON: Well, let me throw this out. On the line of banking, it's an increasing problem --

CHAIRMAN GRUENBERG: It's not the first time it's been mentioned. It's not the first time we've heard it.

MEMBER MENON: -- but, it'd be nice if there could be, I know it's a legislative solution, it's not a regulatory solution, but is there any possibility of any sort of a guidance streamline process, something of that sort.

You know, today, the amount of cash that's sloshing around in some of these economies is pretty bad. It's a safety and security issue for the community and everything else.

So, is there any likelihood of something coming out that'll give us a little bit more confidence in banking some of these guys?

MS. EBERLEY: You know, we can't issue anything. You know, there's a conflict between federal and state law and we're bound by federal law where it remains an illegal activity.

We have asked our examiners that to the extent an institution is banking customers that are in the marijuana business to follow the guidance that's been put out by FinCEN and Justice.

And, that's what we'll check and just check for adherence to that guidance.

At FinCEN, we've had lots of conversations about this and I think there's an interest in clarifying -- an interest on their part in clarifying a direct versus indirect exposure.

And, we've gotten questions about how far down the chain do you go if it's, you know, clearly, if it's a business, if it's a store front selling marijuana, that's clear.

But, if it's an employee of the store front, you know, if it's the employee of the store front and it's now the landlord, that you have the loan on the building where the employee, you know, how far do you have to go?

And, FinCEN has been, in our conversations, talking about clarifying that.

MEMBER THOMPSON: I know there's been a discussion and a focus for FDIC for some time on management succession, forward succession and whatnot and conversations around if there's been M&A activity related to that.

Are you seeing anything change there? Is it kind of the accounting or is getting worse or is it getting better or anything that you've seen in that realm?

MS. EBERLEY: You know, I don't have

any statistics about whether succession management challenges are being addressed. It's not something that we track. It is something that we do talk about in examinations and encourage our examiners to focus on with the Board.

But, and Diane indicated earlier that merger activity had paired off a little bit in the second quarter and we are looking at that on a quarterly basis.

It was a topic of conversation in the April meeting as well that how do you provide liquidity for shareholders that might need liquidity, you know, without going through a merger event or a sale of the institution.

So, you know, it may be something where we can do more research of have more discussion about the challenges. I don't know beyond that what we could --

CHAIRMAN GRUENBERG: I think we could give a little thought to it.

MS. EBERLEY: Yes.

CHAIRMAN GRUENBERG: That'll be for

succession planning is one of the key issues for community banks going forward. And, it's certainly a topic that comes up at almost every meeting I have with community bankers.

And, the thought's perhaps at our next meeting organizing a discussion around succession planning. The guidance that we have, how we engage with institutions around the issue, what our expectations going forward which would all provide for in terms of succession planning for your institutions.

It would be an interesting conversation to have. And that maybe that's something we could think about for the agenda for our next meeting. I would actually find that kind of interesting.

MEMBER DAKRI: I can add to that, having a review change of control and succession planning. That's another thing I'd like to -- some idea of what the thought process is behind as it shifts from generation to generation, if that is the case, what is considered, you know, how is that viewed upon by the FDIC, changing control perspective?

MS. EBERLEY: Okay. So, from a change in management from one generation to the next?

MEMBER DAKRI: Yes, I would use my phrasing.

MS. EBERLEY: Okay.

MEMBER DAKRI: From my dad to me and my brother and et cetera and how it's, you know, how would that work?

CHAIRMAN GRUENBERG: So, in terms of a family owned institution?

MEMBER DAKRI: Yes.

MS. EBERLEY: So, we might ask the question back of you. And, I know we've got a couple of situations at the table where we've got family owned banks with multiple generations of family running the bank.

So, that might be an interesting thing for us to ask you about your experiences and how you've handled it.

CHAIRMAN GRUENBERG: And, not an uncommon issue for community banks.

MS. EBERLEY: Yes.

CHAIRMAN GRUENBERG: As we were discussing at lunch, family ownership is a common feature for community banks. So, it's center for varied interest actually.

I wonder if there are other subject that often comes up which is how community banks manage their relationship with third-party technology service providers, of the issues that you have managing those relationships.

It's -- they are subject that we've discussed previously with the community but it seems to be or diminish it in way as an issue and arguably the challenge for community banks.

So, maybe worth coming back for a discussion on that issues as well. But, I thought I'd get a reaction on your view for that.

MEMBER SCULLY: No, I think that would be terrific because it's not getting any better. I think it's, and I've said this before, I think it's a major threat for the community banking industry model.

Especially with the third-party FinTech providers out there now. Because, if you want that connectivity to the front end payment system, it's in the hands of the core provider as to whether or not you can get it or not.

So, in the oligopoly controlling thousands of banks in this country.

MEMBER BAER PAINE: I think it's -- I'm on the -- we were discussing earlier, I'm on the operations and payments committee for the ICBA. And, this has been a big topic for us on a state level and on a national level.

The challenge is, do you have these larger companies stifling innovation because they are not offering it or they're holding it captive in some way.

We have challenges with specifically a mortgage software not keeping up with regulatory issues. And, I feel that's an area that the FDIC can help assist in.

But, then, communicating an example, we send to ACH required to receive in September, but we're not required to originate until next year.

Whereas a financial institution, it would make sense that we would help our customer with that one topic all at one time. But, the core systems aren't ready. They've known it's been coming, they can't make it happen.

And, it can't work well with, if you have another in ancillary product using your online banking. So, they're not talking to each other, even if one is ready. And, it's a bit of a challenge.

And, then, when you go negotiate your contracts, unless you're leaving and serious about it, that's a challenge.

So, all of these different things come into play. And, we met with the Federal Reserve in Atlanta and had this same conversation in August.

As a regulator, what's your role? How can you help? Well, specifically, you can help with the mortgage software to say, you have to do this kind of a thing.

But, I don't know exactly what your role is except that it's a challenge and it's dangerous to our industry.

MEMBER BEARD: Do you have regulatory authority over them?

MS. EBERLEY: We have -- our authority comes from the Bank Service Company Act. And, what the Bank Service Company Act says is that, we have the authority to exam the services, the technologies providers provide you. So, that's our authority.

And, we do that on an interagency basis. We have central points of contact at each agency for the largest firms, what we call the multi-regional data processing servicers. And, we engage in an annual joint supervisory strategy planning process for those examinations. And, we issue joint reports.

We have been expanding our examination activities to the extent that we can under law over the last several years, including focusing on the enterprise wide governance, focusing on the preparation and the timeliness of readying systems to comply with new rules and including consumer protection rules.

So, we've been working to beef up this program and understand the challenges that you have and appreciate hearing about them. It helps us to focus our examination activities.

MR. PEARCE: And, I would just add on the consumer side, I think it's becoming clear of the salience that technology providers are certainly more central to and integrated into the way the products are being delivered and the way systems are being managed.

And, so, you know, you mentioned mortgage rules and certainly, as the rules have gone into effect, mortgage disclosure rules come to mind in particular, sort of vendor readiness to deliver systems and programs and forms that are compliant with new regulations was a real critical issue that we heard from community banks.

Different levels of satisfaction with the vendors in that process. But, it certainly creates some risk for being able to manage the consumer compliance responsibilities.

And, earlier today, Luke Brown mentioned we have a webinar coming up related to -- on an interagency basis, related to some issues we've seen in overdraft practices, obviously, how those programs operate relying on core providers are a really key element for how some of those programs may be automated and there may be some issues there that banks should be aware of.

So, we certainly see that happening more frequently.

MEMBER DAKRI: Like on the core side, it seems to me that the innovation's really stifled. I mean, there are lots of products out there that we cannot get a hold of because of innovation, the total cost of that.

I think maybe one suggestion I might have as far as trying to speed this process along was the big issue of new ones is the de-conversion cost. I mean, you're basically held hostage the early conversion stuff there because of de-conversion.

If there's a way to say, you know, if I've done my five-year contract, I shouldn't have to pay a de-conversion cost. There should be a nominal amount. It's my data anyway, why would I want to pay a million dollars to get out of this contract.

And, that would probably help these guys and their data. I'm going to lose somebody in five years if I don't keep up, it I don't keep pace on what's going on. That might help all of us over here have a nice little bonus there that other people's actually listen to us now and say, hey, I need this.

MEMBER BEARD: And, maybe a finer point on some of that is FinTech and the challenge that within community banks, we're continuing to have and will have is the FinTech that's better. If we can't respond, we almost abdicate to them.

And, our providers aren't necessarily sensitive to them.

MEMBER TOLOMER: How many people have

changed firms, change third processor -- third-party processors and products with their banking? People don't do it.

And, one is the cost, you're absolutely right. And, two is the concern that the real conversion and many happen to do it and we did in year five and it was somewhat painful, but we were able to pull it off.

But, the attitude of the firm that we were leaving was, do you know what you're going to put your bank through? I said, do you know what you put us through for the first five years? You really did not perform.

And, we've had a much better relationship with the second provider. We have points of contact and we're able to communicate.

But, the other aspect is, when you pull out your contract and you see it's a 168 pages of legalese, we had to hire a consultant to help marshal through that to be able to -- well, to negotiate with the second provider.

And, now, three years into it, we hired

him back to look at, as you grow your bank, your needs become a little bit different and, you know, we don't all of the capability of a firm. So, you need someone to -- so now, all of a sudden two or three years later, your bank is much bigger and has more need for their systems.

But, we were short sighted, arguably, and we signed the contract three years ago. So, now, you have to look to begin to bundle all the services and they're happy to do that with an extension.

So, it's a killer of an issue. And, as long as you're making enough money to be able to pay for the consultant and, the good news is, the consultant we hired really understands the systems so he's able to go to our people and say, let me tell you, I know how all the systems work. This is what you think you're going to need down the line.

But, of course, that's going to change in a year or two as well. So, it's a tough issue, but one that we, you know, we were fortunate that we were able to move away. But, we were clearly felt we were held hostage.

MEMBER KELLY: I do feel it's become a concentration issue.

CHAIRMAN GRUENBERG: It is.

MEMBER KELLY: And, it's just clearly a concentration. It's no different than CRE lending.

CHAIRMAN GRUENBERG: That is a concentration issue in what way?

MEMBER KELLY: You're concentrated to the big four.

CHAIRMAN GRUENBERG: Oh, because of the concentration on the two SP side?

MEMBER DAKRI: I think one thing that might even help, and I don't know if you guys can help us, but even just having access to our own data without having to pay for that, that would be extremely helpful.

And, if I'd rather use a third-party, just that the point that they have in using systems, we're able to do that without a fee.

MEMBER SCULLY: Well, they don't give you access to it, but they also don't store it. I think it's crazy, you know, they control it and they also throw it out every six months.

MEMBER BAER PAINE: I think it's a little bit of a challenge of ownership. Someone on our committee was working with their core system and saying, well, the customers are expecting this. And, they said, the core system said to him, well, those are my customers.

At some point, that core system took over the community bank's ownership of their customers. We don't know how that happened or where that happened, but, for some reason, they feel it's their data and they have to release to us.

So, I think that's a bit of a challenge and, again, working through, is there a standard, a key format that you send out for proposals for all companies? Is there, what's your checklist if you're going to de-convert? If you are going to look at other options, what's the best practices?

Is there a guidance or a best practice to evaluate something that is a huge risk to all of us.

It's our biggest expense that we have and systemically, it's our biggest risk that we have.

So, is there a guidance to say how you evaluate, how do you analyze your core system? Here are good business practices for that.

MS. EBERLEY: We've addressed that through the FFIEC and the Appendix J to the business continuity planning booklet we issued last February.

And, we're updating the outsourcing booklet right now. We've been going through each of the booklets updating.

And, hope that that will be helpful to you.

MEMBER BOEKA: But, still, if you decide to, all right, this is not it and I want out and then go back to this -- the breakup fee that it just puts you out of business.

MEMBER HOWARD: And, part of the

challenge is that, you know, there's a lot of reluctance to make a change on the part of the institutions. And, I think that many of the providers have a sense that they're pretty secure with the bulk of business that we have because there is this reluctance.

And, we, too, changed providers. And, it's a tremendous amount of leverage that you have when you decide to change. It takes a lot of courage to change and, you know, have to swallow a little.

But, I mean, when you, at that point, you have the opportunity to negotiate an agreement that's far more acceptable than maybe the one that you're living with.

And, when you also, at that point in time, have the opportunity to, you know, demand certain performance requirements. Maybe they don't have them today, but, you know, you kind of put some teeth in the contract because they're all looking, you know, there's not that many of them, they're all looking for business.

So, to some extent we sort of, you know, support their notion that we're a stable book of business because of the reluctance on our part to change.

CHAIRMAN GRUENBERG: It sounds as if they've also structured their relationship to make it as difficult and costly for you as possible because it gives them leverage. That's built into the relationship it sounds like, it sounds to me.

MEMBER HANRAHAN: So, as you're developing your de novo handbook, this would be, seriously, this is a topic I thought little about when we started the bank.

And, the best time to start to negotiate terms is when you've got options and everybody wants you. And, once you get your contract, you're stuck with your contract.

It's, I think it'd be a subject worth well enough for de novo organizers.

MS. EBERLEY: Thank you.

MEMBER HARTINGS: Just to tag on that, if you create a vendor best practices, what we should be looking at is our contracts, please also articulate that to the largest providers that you examine as well.

So, if you give it to me to ask my core processor, I would hope that you've presented that to the core processor when you're in there examining them.

And, I know, FDIC did that through FFIEC but that's the -- there's sometimes a disconnect there.

You want us to do this and we ask our core provider and they say, no, we're not going to do that. We're not going to put it in your contract.

MEMBER SCULLY: Or they're going to charge you more to do it.

MEMBER HARTINGS: Yes, yes.

MEMBER SCULLY: And, they've got all of us when they've had requests for information from the regulators. They've complied and charged us for that.

MEMBER HARTINGS: So, we need you to

help us with the push back a little bit.

MEMBER SCULLY: You have the leverage.

MEMBER HARTINGS: Yes.

MEMBER SCULLY: At least you have more leverage than any of us in this room do.

MEMBER BOEKA: Who plays a part in approving of acquisitions of one core system buying another and another and another of these new ones?

MS. EBERLEY: There's no regulatorial approval process. It would be just subject to normal kind of --

MEMBER BOEKA: DOJ?

MS. EBERLEY: -- DOJ standards on --

MEMBER BOEKA: It would be good if they have to go through the same regulatory approval that we have to go through when buying other banks.

MEMBER BEARD: That's an interesting discussion, because, if you think about it from the historical standpoint, it's evolving very rapidly to where the technology is more and more important than probably 20 years ago. It wasn't even a thought, but you don't have maybe the sole authority over it, but you've got a lot of the banking that has gone out of the banks into this stack. It is somewhat regulated, but you're regulating the user.

K: And, it does seem the data, that's the biggest thing to me that is the risk. Releasing the data, but it's not ours to being with. I mean, we're just the keepers of the customers.

So, maybe if that can be examined during the examination process. We would keep the data, historical data forever and why would they not do that? That doesn't make any sense. Maybe that's --

MEMBER SCULLY: That makes perfect economic sense for them.

MEMBER THOMPSON: This is their big issue. I'm going to ask this -- my question on a different one, though. So, if I sound smart, it's because I'm using Chris's comment at lunch.

You did bring up to Mark at lunch and had this been -- had it been considered to do this type of activity on a more local or regional level with even a smaller group or whatnot? Maybe expand on whatever else your thoughts were.

MEMBER EMMONS: Are we talking about financial entercy? Is that what you're --

MEMBER THOMPSON: No, this advisory group.

MEMBER EMMONS: Oh, oh, oh, okay, sorry.

Yes, I just -- we were reflecting on the effectiveness of this meeting and these sessions because it's -- for us, it gives us the opportunity to have a little more intimate contact with our regulatory friends.

And, for most institutions, most bankers, they only see their regulators at the most critical junctions when an examination takes place.

And, these conversations tend to be very constructive and it occurred to me that more of this is better and not necessarily for this group, but to perhaps push this down into some of the regional offices as a best practice to bring bankers together, talk about some of the same issues or other issues that, perhaps, we haven't touched on.

That might -- we're going to build on those relationships that community bankers want to have with the regulators and vice versa.

So, just think it's the fact that you're listening is really important. And, I think that's good for our banking relationship.

So, that's all I was intending.

CHAIRMAN GRUENBERG: That was a -- I think that's an interesting thought. I would say, though, a considerable amount of effort goes into the preparation for these meetings. So, we'd have to just think about it from a resource standpoint.

But, it's certainly something we can talk about with our regional directors.

MEMBER HOWARD: I mean, I certainly, I agree with you. I think that these conversations are critical. And, I shared with the Chairman and others in the past. We have one tomorrow, actually, in Hartford with our regional office.

And, we probably have every year to 18 months or something like that. So, I think that the region, at least in our experience, the regional offices are open to --

MEMBER BOEKA: San Francisco does the same thing. They are very good, very good meetings.

MEMBER TURNER: Kansas City does, too. Our regional director goes all over his region periodically and we probably wind up meeting with him every couple of years, a group of bankers. So, it happens frequently.

MEMBER BEARD: I think they've been good at it. In fact, the commissioner, he came out and their chairman, you came out to San Francisco. I know Stan Ivie had us come over. And, I thought that was helpful. And, he's been very good. I think Cathy all is now doing that with --

And, it's a fairly intimate discussion where there's not a lot of people and it's helpful.

MEMBER EMMONS: One more shift in the conversation. One of the things that has become a fact of life for us these days, relates to the security side and it's the compromised card the role of security where we have endless lists of data that comes into the bank on the multitudes of retailers and others that have been -- information has been obtained.

And, we get these lists and the cost associated with that, monitoring those and replacing cards has, for us, it's just, it's on a steady incline.

And, it feels like that we've got the MV chip and now we're doing things to try to minimize the loss to the consumer. But, the costs to the banks for replacing cards and -- or PIN numbers or all of the things that you do in communicating with your customers when this happens, it just feels like it's an epidemic.

It used to be you might have three or four over the course of a year and you'd get everybody together and you talk about what you're going to do. Well, let's replace these cards.

Now, it's like it's every day that we

have, you know, we have a list that, you know, and it can be, for us, it can be a 100 to 200 names that seem to be hitting the radar.

And, it just feels like it's an endless kind of exercise, one that's costly to the banks. And, I would point that out as not that I have the solution, but that it is -- I think it's a growing concern.

And, I'm worried a little bit that we kind of, because it's become a fact of life, that it's just one that we seem to be comfortable living with.

But, you know, when my operations folks talk about or my security team gets together and we talk about it, it's just, it's constant and I worry that it's -- I don't see any solutions on the horizon.

MEMBER SCULLY: It's a cost allocation issue, again. And, it's -- I mean, it's not directly and your hand are legislative. But, you know, the people that cause the breach don't bear the costs of replacing these cards.

MEMBER TURNER: So, we're the fraud losses. Yes, I mean, there can be emergent breach that may cost out bank $600,000 and we aren't getting anything back from the merchant. Maybe, say MasterCard or Visa has some penalties that they assess and maybe a bit of that will come back our way, but very little.

MEMBER EMMONS: So, we spend a lot of money on detection systems and, you know, we try to catch them early and it's a few dollars here and there. But, it just feels like it's almost become part of the wallpaper.

MEMBER SCULLY: It is, it's a permanent cost of doing business now.

MEMBER EMMONS: And it feels -- it's very uncomfortable. And, I'm not sure from a customer standpoint that they really get what's going on and who's -- I think they somehow we're always the accountable party.

But, it just feels like --

MEMBER SCULLY: They get mad if you -- if they lose money but they also get mad if you take their card away so they don't lose money. It's a lose-lose unique situation.

But, I think, again, I think it's just a leverage issue. If there's anything you can do as, you know, somebody that understands the problem in aggregate because individually, we don't have the leverage.

CHAIRMAN GRUENBERG: Well, we will -- this is very helpful, by the way. And, in terms of the agenda for the next meeting, we'll also planning a part of the initiative we started with academic institutions on this issue of the next generation of the bankers. I think that's a very good topic to get on as well. And, I think there's some potential there.

So, you've given us things to work on for our next session.

Doreen, Mark, anything else? Anything else? Going once, going twice.

MS. RYAN: I just want to mention that the next meeting, the meetings next year have not yet been scheduled. But, we'll be reaching out to everybody to find dates for the three meetings.

CHAIRMAN GRUENBERG: Thank you.

(Whereupon, the above-entitled matter went off the record at 2:44 pm.)