

The Meeting of the Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

July 12, 2017 – 9:00 A.M.

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

The members of the Committee present at the meeting were: Richard T. Beard, President and CEO, People’s Utah Bancorp, American Fork, Utah; Roger Busse, President and CEO, Pacific Continental Bank, Eugene, Oregon; Asif Dakri, Vice Chairman and CEO, Wallis State Bank, Houston, Texas; David J. Hanrahan Sr., President and CEO, Capital Bank of New Jersey, Vineland, New Jersey; Chandler Howard, President and CEO, Liberty Bank, Middletown, Connecticut; Danny J. Kelly, President and CEO, Hometown Bank of Alabama, Oneonta, Alabama; Tiffany Baer Paine, President and Chief Executive Officer, Security Bank USA, Bemidji, Minnesota; Mary Ann Scully, President and CEO, Howard Bank, Ellicott City, Maryland; John M. Tolomer, President and CEO, The Westchester Bank, White Plains, New York; and Joseph W. Turner, President and CEO, Great Southern Bank, Springfield, Missouri.

Adriana M. Boeka, President and CEO, America United Bank, Glendale, California, Christopher W. Emmons, President and CEO, Gorham Savings Bank, Gorham, Maine, Jack A. Hartings, President and CEO, The Peoples Bank Co., Coldwater, Ohio, Arvind A. Menon, President and CEO, Meadows Bank, Las Vegas, Nevada, and Gwen M. Thompson, President and CEO, Clover Community Bank, Clover, South Carolina, were absent from the meeting.

Corporation staff who attended the meeting included: Ruth R. Amberg, Ryan Billingsley, Rebecca Bittle, Richard A. Brown, Suzanne L. Clair, Patricia A. Colohan, Kymberly A. Copa, Debra A. Decker, Doreen R. Eberley, Diane Ellis, George E. French, Carlos C. Galvan, Shannon N. Greco, Frances M. Grillo, Patricia S. Gurneau, Margaret Hanrahan, Nicholas Kazmerski, Matthew Kepniss, M. Anthony Lowe, Christopher Lucas, Thomas F. Lyons, Peter Martino, Sydney Mayer, Jonathan N. Miller, Rae-Ann Miller, Noreen Padilla, Mark E. Pearce, Sylvia H. Plunkett, Claude A. Rollin, Barbara A. Ryan, Robert F. Storch, Danielle Unterschut, and Angela A. Wu.

William A. Rowe, III, Deputy to the Chief of Staff and Liaison to the FDIC, Office of the Comptroller of the Currency and Jocelyn Chandler, Advisor to the Director, Consumer Financial Protection Bureau, were also present at the meeting.

Chairman Gruenberg welcomed the Committee and began by recognizing Anthony Lowe who recently accepted appointment by the FDIC Board as Ombudsman. Chairman Gruenberg next provided an overview of the day's program. Chairman Gruenberg said the first panel would provide an update on Economic Growth and Regulatory Paperwork Reduction Act ("EGRPRA") implementation initiatives. The second panel then would cover emerging issues in supervision. Chairman Gruenberg said the third panel would provide an update on De Novo applications. Following the lunch break, he said, there would be a panel on post crisis community bank performance and outlook. The fifth and final panel would provide an update on supervisory policy issues. Chairman Gruenberg then introduced Barbara Ryan, FDIC Chief of Staff and the Designated Federal Officer for the FDIC Community Banking Advisory Committee ("CBAC"), who moderated the rest of the day's proceedings.

Ms. Ryan introduced Ruth Amberg, Assistant General Counsel, who led the "EGRPRA implementation initiatives" panel. Ms. Amberg began by providing an overview of the EGRPRA process, its purpose and focus. She said the bank regulatory agencies recently submitted their joint regulatory review report to Congress in March, 2017. She explained that the report sets forth how the three-year review was conducted and what has been done by the FDIC and other agencies to address regulatory burden. Ms. Amberg said that EGRPRA requires the banking agencies to review their regulations at least once every ten years to identify any outdated or otherwise unnecessary regulations. She said, consistent with EGRPRA, the agencies grouped the regulations into twelve categories and then welcomed comment from bankers and others through four Federal Register notices; in addition, the agencies held six public outreach meetings to provide an opportunity for bankers, consumers, and community groups to present their views directly to agency principals and senior management on any of the regulations subject to EGRPRA review. Ms. Amberg pointed out that a number of CBAC members served as panelists in the outreach sessions and thanked them for their participation. She said the review process focused on the effect of regulations on smaller institutions such as community banks and savings associations. Ms. Amberg reported that altogether, the agencies received over 250 comment letters from financial institutions, trade associations, consumer and community groups, and individuals, as well as numerous written and oral comments at the outreach meetings. Ms. Amberg stated that today's overview would provide an update on four key initiatives currently underway, specifically Consolidated Report of Condition and Income ("CALL") report streamlining, appraisals, capital and exam modernization. Ms. Amberg then introduced Robert Storch, Chief Accountant, Division of Risk Management Supervision ("RMS"), to provide an overview of efforts to streamline CALL reports.

Mr. Storch explained that the agencies received comments on CALL report burden both as part of the EGRPRA review and outside of the review process. Acknowledging that institutions find the CALL report burdensome, Mr. Storch said the Federal Financial Institutions Examination Council ("FFIEC") directed its task force on reports to undertake a community bank CALL report burden reduction initiative starting in December 2014. He said that although the focus of the effort is on community banks, the task force is also pursuing opportunities to reduce the CALL report burden on all institutions. Mr. Storch reported that among the actions

the task force and agencies have taken is the introduction of a new streamlined FFIEC 051 CALL report for eligible small institutions which is (initially) defined as “institutions with only domestic offices and less than one billion dollars in assets.” He added that the finalization of the new report was announced on December 30, 2016 and the FFIEC 051 report became available for first quarter 2017 reporting purposes. Mr. Storch commented that the other two FFIEC CALL reports, FFIEC 041 and 031 also took effect in the first quarter 2017. He noted that eligible small institutions have the option of filing the FFIEC 051 or continuing to use the FFIEC 041 CALL report. Mr. Storch reported that almost two thirds of the eligible small institutions elected to use the FFIEC 051 report as of March 31, 2017. He added that as 2017 is the transition year for the implementation for the new streamlined CALL report, the FFIEC has taken a flexible approach regarding institutions use of the new report; those eligible small institutions that did not file the 051 CALL report as of March 31, 2017 may begin reporting on the new version of the CALL report as of June 30, 2017, or as of later dates in 2017. For reporting in 2018, the one billion dollar asset size test for eligibility for filing the 051 will be based on the total assets the institution reports in its June 30, 2017 CALL report. Finally, Mr. Storch reminded that the revisions made to date are not the end of the streamlining efforts and that the agencies will be issuing additional burden reduction CALL report proposals in 2017. Mr. Storch commented that the banking agencies published a Federal Register notice on June 27 that requests comment for 60 days on further proposed burden reducing revisions to the three versions of the CALL report. He said that the CALL report proposal that is currently out for comment would remove, raise the reporting threshold for, or reduce the reporting frequency for approximately 7% of the data items in the FFIEC 051 CALL report for small institutions. The proposal also includes similar actions that affect between 10% and 12% of the data items in the 041 and 031 CALL reports respectively.

Finally, Mr. Storch commented that in last year’s Federal Register Notice proposing the streamlining of the FFIEC 051 CALL report, the banking agencies stated a commitment to explore alternatives to the one billion dollar asset size threshold that generally determines an institution’s eligibility to file the FFIEC 051 CALL report. He said that the FFIEC task force on reports plans to begin the effort this quarter, the task force will be evaluating CALL report data from institutions of various sizes in excess of one billion dollars in assets particularly with respect to their involvement in complex and specialized activities for which only a limited amount of information is now collected in the FFIEC 051 CALL report compared to the more detailed data on these activities that is currently reported in the FFIEC 041 CALL report. Mr. Storch added that the task force’s goal would be to ensure any proposed expansion of the eligibility to file the FFIEC 051 CALL report would not result in the loss of data critical to effective supervision and the conduct of other missions by the FFIEC member entities and any proposal to expand the eligibility for the 051 would need to be published in the Federal Register for industry comment. Mr. Storch then welcomed any questions or comments from the Committee.

Member Howard asked if there is still progress being made on including a line item on the CALL report for those institutions that have equity portfolios. Mr. Storch responded yes and further added that the recently issued proposal includes adding a specific line for the gains and losses on the equity securities.

Member Turner asked for clarification on what type of data for complex activities were at risk of loss if the eligibility size is increased for the simplified CALL report. Mr. Storch responded that the complex activities (that the FDIC collects data on) are derivative activities, securitization activities, asset sale activities, loan servicing, the use of fair value option, the existence of variable interest entities. He further explained that in comparing two institutions (both in excess of one billion dollars in asset size), one of which is actively involved in one or more of the complex activities, then there may be a strong supervisory need to continue collecting detailed data as compared to a “plain vanilla” institution that does not need such monitoring.

Ms. Ryan then introduced Rae-Ann Miller, Associate Director, RMS, to discuss the advisory notice on appraiser availability. Ms. Miller began the discussion by pointing out that the topic of appraisals was frequently commented on in the EGRPRA process, in particular there were comments on the monetary thresholds that are set forth in the interagency appraisal regulations for when appraisals verses evaluations are required by the agencies. Ms. Miller reminded that the current thresholds that have been in place since 1994 are \$250,000 for CRE and residential transactions and \$1,000,000 for business loan transactions (business loans being those where repayment is not based on rent or sale of the property). She said that some commentators said that the thresholds should be raised while other commentators found that they provide important safety and soundness consumer protection considerations and should remain as they are. Ms. Miller noted that another frequently commented on topic was the scarcity of appraisers in rural areas. Ms. Miller indicated that in the EGRPRA report, there are three different actions discussed. The first action involves raising the appraisal thresholds for CRE transactions from \$250,000 to \$400,000 (recently issued as a Notice of Proposed Rulemaking for discussion). The second action discussed in the report is in March of 2016, the FDIC issued an advisory to remind the industry that appraisals within the threshold are not required to have an appraisal by FDIC regulation as well as summarize outstanding guidance on what is appropriate to include in an evaluation. The third action discussed in the report concerns the scarcity of appraisers. Ms. Miller continued to explain that in, May of 2017, the FDIC issued an advisory on the availability of appraisers and informed the industry of two existing options that may help alleviate challenges associated with appraiser shortages; one option being the ability of States to grant temporary practice permits for an appraiser credentialed in a different State, the second option being a temporary waiver of the statutory requirement to have licensed or certified appraisers perform related transactions. Ms. Miller said that the FDIC is currently working with State regulators on the issue of scarcity of appraisers. Ms. Miller then invited any questions or comments from the panel.

Member Hanrahan asked whether raising the threshold amount would be driven by the type of real estate or the type of transaction. Ms. Miller responded that a commercial loan, regardless of who it is extended to, if it is for construction only, then that is a construction loan. If it is an improvement to an existing home, that tends to be a residential transaction and would not fall under the new threshold. Member Hanrahan asked for as much clarity and detail as possible when the rule is written.

Member Tolomer asked for clarification on the \$1,000,000 threshold and whether the threshold would include owner occupied. Ms. Miller answered yes.

Member Beard asked whether there was any discussion on indexing the threshold numbers to inflation. Ms. Miller responded that the question comes up whenever dealing with thresholds and for reasons dealing with transparency and clarity, indexing the thresholds to inflation has not been adopted.

Member Dakri asked if there were other options or solutions being looked at with regard to the shortage of appraiser issue. Ms. Miller responded that she is looking forward to getting more feedback from the outreach sessions. She pointed out that there appeared to be some confusion regarding evaluations and that in fact a broker can perform an evaluation so long as there is the appropriate information to support the value.

Member Baer Paine commented that her institution is located in a rural area and there is a need for appraisers, specifically commercial. She said that her institution is in the middle of the state, so sharing an appraiser from another state doesn't really help. Chairman Gruenberg commented that working with the State Commissioner may be the appropriate avenue of relief.

Ms. Ryan then introduced Ryan Billingsley, Associate Director, RMS, to discuss efforts to simplify the capital rules. Mr. Billingsley began by saying that, as part of the EGRPRA process, comments were received regarding the banking agencies' capital rules, most of the comments focused on the complexity of either the entire rules or some part of the rules, urging the banking agencies to consider a simpler alternative. He said that with the help of these comments, the banking agencies identified several areas of the capital rules that could be modified to provide burden relief. The first area, he said, involves replacing the regulatory capital frameworks complex treatment for high volatility commercial real estate ("HVCRE") with a more straightforward treatment for most acquisition, development and construction loans. The second area, he said involves simplifying the regulatory capital treatment for mortgage servicing assets, certain deferred tax assets and holding regulatory capital instruments by financial institutions. The third area, he said involves simplifying the current limitations on the inclusion of minority interests on regulatory capital. Mr. Billingsley noted that the banking agencies would be seeking comment on these three areas through the normal comment process. Mr. Billingsley then welcomed any comments or questions from the Committee.

Member Busse asked when the comment process will begin. Mr. Billingsley stated as to the three areas noted in the EGRPRA report, the rules are currently being worked on and should be ready soon.

Chairman Gruenberg commented that the FDIC is considering an approach that would deem institutions compliant with risk based capital rules that have both a strong leverage capital ratio and do not engage in certain risky activities.

Member Scully said that even though the topic of capital does not often take up much space on the agenda, it remains very much an important issue to the industry.

Ms. Ryan then introduced Doreen Eberley, Director, RMS, and Ms. Miller to discuss proposed examination modernization efforts. Ms. Miller began by pointing out that (as noted in the EGRPRA report) regulatory burden not only emanates from statutes and regulations, but also from the processes and procedures related to examinations and supervisory oversight. In this

regard, she said that the examination process, tools and the reports were each evaluated to see if they could be made more effective and efficient without sacrificing the quality of the exam process or product. Ms. Miller indicated that the current project being focused on is modernizing the safety and soundness examination process and this is viewed as a long term project.

Ms. Miller said that the current examination process has been in place for a long time. She commented that before the current examination method, up to the mid-eighties, exams were conducted on a surprise basis. Ms. Miller said that the FDIC moved from the “surprise” exam to the “risk focused” approach, so exam resources were tailored to the size, complexity, risk profile, and business model of the particular institution being examined. She noted that the FDIC adopted a “common core” examination report that had certain mandatory sections utilized by all of the FFIEC agencies. Ms. Miller next mentioned that the examination process has been augmented by technology which has allowed regulators to perform work more efficiently either onsite or pre-exam. Finally, she touched on the Uniform Bank Performance Report (“UBPR”) and the advances that have been made to the UBPR including peer customization, additional analytical pages, and the availability of the underlying data.

Ms. Miller next discussed the three different parts of the current project which are the examination process, report of exam, and exam tools. In terms of process, Ms. Miller stated that a current goal is to see if technology can be leveraged even more to make exam activities more efficient and provide opportunities to minimize on site presence. Next, Ms. Miller said that the format of the report itself is being reviewed. With respect to the UBPR, she said an effort is being made to make the report more user-friendly and informative.

Ms. Miller then went over the “Examination Modernization Proposed Discussion Topics for FDIC Community Bank Advisory Committee” handout with the Committee.

Member Tolomer reported that his institution had a positive experience with the recent examination process. He added that if the examination process is conducted well then the length of the cycle (12 or 18 months) is not really important. Member Tolomer stated that his institution views the process as a way for the Bank to improve.

Member Hanrahan agreed with Member Tolomer except for the point about the eighteen month exam cycle which he felt would be a vast improvement.

Member Baer Paine asked whether the FDIC is working with the States. Ms. Miller responded yes and every effort is made to be as consistent as possible.

Member Howard commented that having the regular conversations during the exam is very helpful.

Ms. Eberley asked the Committee for feedback on best practices in the context of communicating with banks informally as opposed to formal direction. Member Tolomer commented that his experience is that it is better to get the direction sooner, up front. Member Scully agreed with Member Tolomer that the informal guidance is invaluable.

Ms. Miller then moved to the second topic concerning the examination report and welcomed comments on how it could be possibly improved upon. Member Howard commented

that he would like to see the exam report written as clear and as detailed as possible so as to make corrective measures easier to implement. Member Scully agreed with this point. Ms. Miller responded that clarity of comment is something that examiners strive for and in fact, the Board requires.

Member Hanrahan asked whether peer data could be made available concerning examination scores. Ms. Eberley responded that while it was an interesting idea, the reality is that there would be many practical difficulties with including such analysis.

Ms. Miller next asked the Committee for comment on the third topic concerning the UBPR and related reports and data and ways to make them more informative. Member Scully commented that one of the most important things would be the ability to customize. Member Busse agreed that anything that could be done with customization would be welcome. Member Howard commented that outside the customization, he thought the report was fine. Member Dakri commented that adding charts and graphs to enhance the visual aspect of the report would be helpful.

The Committee stood in recess at 10:29 a.m. and reconvened at 10:51 a.m. that same day.

Ms. Ryan introduced the next panel to discuss emerging issues in supervision and liquidity risk. Ms. Ryan introduced the panelists: Doreen Eberley, Director, RMS, George French, Deputy Director, RMS, and Susan Clair, Chief, Exam Support, RMS. Mr. French began by stating that the industry continues to see recovery following the crisis; loan growth increased from 2014 to 2016. He pointed out that given this is an upcycle, it is very important to have strong risk management practices. To continue the discussion, Mr. French then utilized a slide deck. He said that the theme of his presentation is “liquidity risk is increasing.” Mr. French referred to the slide titled “non-core funding of liquid assets,” the message of the slide being that non-core funding has been increasing relative to liquid assets for all three groups of insured banks (those concentrated in CRE, ADC and AG) since 2012, the three groups consisting of 328 banks with ADC concentrations greater than 100% of capital, 1541 banks with CRE concentrations greater than 300% of capital, and 477 banks with AG loans greater than 300% of capital.

Moving on to slide deck #3, Mr. French said that the slide describes a different look at similar issues, showing that among the ADC and CRE concentrated banks in the previous slide that rely more heavily on wholesale funds (wholesale funds more than 20% of assets), these banks are growing rapidly by wholesale funding. Mr. French pointed out that the slide tends to demonstrate that these banks may be exposed to liquidity risk under a stressed set of conditions (such as an unexpected asset quality problem).

Member Scully asked for clarification on the definition of non-core funding. She pointed out that definition of non-core funding in the first slide on page 2 is identical to the definition of wholesale funding except for an estimate of uninsured deposits. Mr. French responded that uninsured deposits can be relationship deposits and he would be hard-pressed to call them wholesale as a blanket category. But, he explained, for purposes of looking at potentially more credit-sensitive funds when the institution is under stress, they were included as non-core for the chart.

Mr. French next moved to a slide that illustrated some of the common characteristics of liquidity failures during the financial crisis in 2008 and 2009. He pointed out that some of the common characteristics of liquidity failures included: below or borderline well capitalized; significant asset growth, high volume of CRE loans, rising past dues/non-performing assets; earnings above peer yield on loans and leases; liquidity level, low level of short term investments, high percentage of securities pledged, high percentage of assets in loans/leases; above peer non-core funding dependence, high level of brokered deposits. All of these indicators, Mr. French said, were generally suggestive of institutions that were taking on a higher appetite for risk.

Member Turner asked if there has been a qualitative review of the type of loans that caused the problems that led to the last crisis. He added that it was his perception that it was speculative subdivision, condominium type development as opposed to stabilized, multi-family projects or stabilized retail that led to the crisis. Mr. French responded that there is a concentrations page as part of the examination where examiners delve into how lending concentration is being managed. He mentioned there is also an underwriting survey that examiners are asked to complete after each safety and soundness exam which helps to provide a horizontal look at the kind of issues that examiners are seeing. Mr. French then turned the discussion over to Ms. Clair.

Ms. Clair began by going over some of the steps the FDIC is taking in response to liquidity risk. She said that in light of the trends discussed by Mr. French and other indicators, the FDIC has been reminding examiners of the existing guidelines and that strong risk management and contingency planning are very important. Ms. Clair pointed out that since the crisis, the FDIC has been enhancing offsite liquidity risk monitoring efforts and recently made liquidity part of the quarterly monitoring and tracking program. Ms. Clair reported that the FDIC is developing a suite of informational videos designed to both assist with best practices and contain helpful exercises. Along this same line, she said the FDIC is working with the other agencies to host an industry webinar (conference call) to address liquidity risk which is anticipated to occur in early fall and will also be open to examiners. Finally, Ms. Clair said that the FDIC will publish an article focused on liquidity and funding in the summer Supervisory Insights Journal. She said this article will touch on some of the recent trends, risk management practices, and insights on scenario testing and contingency funding planning.

Member Busse offered a comment that the migration of watch credits, both in number and dollars, was one of the best early warning signs of deterioration. He indicated that careful monitoring of this migration had an impact on his Bank's capital planning process. Member Busse recommended that banks have an accurate and timely risk-rating system for migration and watch credits to better detect potential deterioration.

Member Hanrahan asked for clarification on slide 4, whether the "low level of short term investments, high percentage of securities pledged" was against peer. Mr. French responded that this is a qualitative observation of those institutions that suffered liquidity failures during the financial crisis.

Ms. Ryan then introduced the next panel to provide an update on de novo applications. She reintroduced Ms. Eberley and introduced Patricia Colohan, Associate Director, RMS. Ms.

Colohan began the discussion by referring to a chart depicting the deposit insurance application activity that has occurred since 2011. She said the first section of the chart shows the four pending deposit insurance applications and shows that in June the FDIC received three new deposit insurance applications: (1) Beacon Community Bank, Charleston, South Carolina; (2) SoFi Bank, Salt Lake City, Utah; and (3) Charles Schwab Trust Bank, Henderson, Nevada. Ms. Colohan next moved to the second part of the chart which shows that the FDIC approved three additional deposit insurance applications in June: (1) Tennessee Bank and Trust, Nashville, Tennessee; (2) Winter Park National Bank, Winter Park, Florida; and (3) Infinity Bank, Santa Anna, California. She said this brings the total number of FDIC deposit insurance application approvals since 2011 to nine.

Ms. Colohan stated that the FDIC welcomes applications for deposit insurance and that entry of new banks helps preserve the vitality of the community banking sector and fills important gaps in local banking markets. She said that in evaluating deposit insurance applications, the FDIC generally expects to finish its process within four to six weeks after accepting an application as substantially complete. She then turned the presentation over to Ms. Eberley to continue the discussion regarding initiatives the FDIC has taken with respect to deposit insurance applications.

Ms. Eberley began by referring to the draft handbook for organizers of de novo institutions that was provided at the last meeting and was finalized in May. Ms. Eberley pointed out that several comments received by the Committee were incorporated into the handbook (expanding the discussion about selecting a technology service providers being one example).

Next, Ms. Eberley said in May the FDIC concluded its outreach efforts at each of the FDIC regional offices to walk through the essential steps of forming a de novo bank; in each of the sessions the three stages of the application process, the pre-filing meeting, the development of the application and the filing and evaluation process were discussed. Ms. Eberley reported that points of contact at each agency (including chartering agencies) were provided.

Ms. Eberley provided a brief recap of the content of the outreach sessions. First, she said there was a description of the content of the business plan and a discussion of business plan development. Next she said there was a review of the statutory factors that the FDIC considers when reviewing a business plan including capital and earnings. Ms. Eberley said the sessions also had a section devoted to listening to local bankers that had successfully navigated the de novo process (Member Hanrahan and Member Tolomer were recognized and thanked for their contributions). Finally, she said there was discussion of the steps involved with assembling a management team and developing the compliance program. Ms. Eberley noted that at each of the sessions there was tremendous discussion and the response to the events was very positive.

Ms. Eberley next said that earlier in the week, an internal procedures manual for evaluating and processing applications was issued for public comment. She then welcomed any comments or questions from the Committee.

Member Howard asked if any of the new banks were on-line banks as opposed to more traditional banks. Ms. Eberley answered that the vast majority are traditional banks, the exception being SoFi Bank which is an internet bank. Member Scully asked if there were any

characteristics in terms of high growth markets, low growth markets and/or capital levels. Ms. Eberley responded that the applications have been in recovering markets, more rapidly growing economies. She said the range of third year assets has been between about 250 million to 400 million dollars.

Member Busse commented that a de novo institution interjects health and vibrancy into the community and complimented the FDIC on its efforts to promote de novo institutions. Ms. Eberley added that the FDIC continues to have pre-filing meetings, including some in the middle of the country.

Member Howard asked if Ms. Eberley could comment on the performance characteristics of (the few) electronic banks. Ms. Eberley responded that there were several types of models, some exclusively on-line and others partly on-line, competing on price as well as competing on accommodation for customers. She said these banks have the same regulatory requirements as more traditional banks in terms of start-up. Ms. Eberley further commented that there will be differences in how the on-line banks meet their Community Reinvestment Act (“CRA”) responsibilities making the pre-filing meeting very important.

Member Beard asked if there was anything the members of the Committee could do to assist with the process, such as talk with an incoming CEO. Ms. Eberley thought it was an excellent idea and resource.

Chairman Gruenberg then expressed that the industry is perhaps experiencing an inflection point in the post-crisis period in terms of de novo institutions. He commented that post crisis, this has been the longest period of zero or very low interest rates since the FDIC was created and this has been perhaps fundamentally, an obstacle to de novo creation. Chairman Gruenberg pointed out that the Federal Reserve has raised interest rates three times within the last year and from a market standpoint there will likely be a rising interest rate environment for the foreseeable future. The Chairman stated that the increased interest in de novos and de novo activity is perhaps not coincidental to the rising interest rate environment.

Member Kelly commented that monitoring cost is a very important issue for de novo institutions. He remarked that one of the major issues his institution ran into was the development of the management team and that necessarily involves the outlay of funds. Member Turner added that it is also important to educate potential investors concerning reasonable expectations as to profit and growth levels.

Member Beard commented on an exercise that was performed in a Western Independent Bankers (“WIB”) meeting. He said that in that exercise, bank directors were put together in various groups and each group was asked to analyze a particular hypothetical bank’s performance year-by-year. Member Beard said what was interesting about the exercise is that each of the groups generally found that the hypothetical bank was doing well. Member Beard explained that the hypothetical bank was in fact modeled on a bank in southern Utah that eventually failed. Member Beard mentioned that the exercise was effective because many of the directors were not bankers and they were analyzing the hypothetical bank’s performance from a businessperson’s standpoint (as opposed to a banker). Member Beard added that the feedback from the exercise is that many of the bank directors were surprised that capital could evaporate

so quickly. Member Beard mentioned that he would be happy to put the President of WIB (Michael Delucchi) in touch with the appropriate contact at the FDIC to provide the material. Ms. Eberley commented that she thought it was a wonderful idea and targeted training for de novo directors (under video programming) such as this could be very helpful.

Chairman Gruenberg asked if Ms. Eberley could give more insight into the timeframe for applications in the sense of policy and procedure. Ms. Eberley responded that the policy of the FDIC to process an application 120 to 180 days from receipt of a complete application. She added, there is a good deal of discussion regarding what makes for “a complete application.” Ms. Eberley explained that generally, what makes a complete application is an application that answers all of the questions set forth in the application form. Ms. Eberley said that case managers are given 30-45 days to complete the process (of evaluating an application for completeness). If the conclusion (after review) is that the application is complete then it is deemed complete as of the date that it was initially received by the FDIC. Ms. Eberley further explained that when an application is received the case manager is asked to provide the supervisor of the field office (where the investigation will be conducted) a heads up so that the field manager can begin planning. She added that the investigation team will also be coordinating with the chartering agency (either the State or the OCC) in the process. During the first 30 to 45 days, Ms. Eberley continued, the case manager will be communicating with the chartering agency to obtain their perspective. She added that the communication helps the de novo institution get consistent feedback as the process continues. The next step in the process Ms. Eberley explained is the field investigation which takes about sixty (60) days. She said that during that period, the investigating examiner will meet and interview each of the prospective (de novo bank) directors both individually and as a group, interviewing the management team, interviewing other institutions in the marketplace, possibly interviewing community groups, and evaluating the viability of the de novo’s business plan (does it make sense). Ms. Eberley added that the examiner will evaluate each of the statutory factors, the financial history, condition, the adequacy of the capital, the general character of the management, earnings, the reasonableness of earnings, convenience, needs of the community to be served, whether the corporate powers are consistent with the FDI Act and the risk presented to the Deposit Insurance Fund. She said that the examiner will write up all of their findings in a report of investigation that will be submitted back to the Regional Office to the case manager. At that point, she continued, the case manager has another 30-45 days to evaluate the field investigator’s work, their recommendations and make a final recommendation to the Regional Director. Finally, Ms. Eberley said, there is a concurrence process with Washington D.C. on the back end that hopefully lasts no more than two (2) weeks.

Chairman Gruenberg thanked Ms. Eberley for her summary.

The Committee stood in recess at 11:49 a.m. and reconvened at 1:26 p.m. that same day.

Ms. Ryan introduced the first afternoon session panel titled “Post-crisis Community Bank Performance and Outlook.” Ms. Ryan introduced the panelists: Diane Ellis, Director, Division of Insurance and Research (“DIR”), Margaret Hanrahan, Chief, Financial Analysis, DIR, and Richard Brown, Chief Economist, DIR.

Ms. Ellis began by explaining that there was a new segment to the Quarterly Banking Profile (“QBP”) that deals with the performance and trends associated with community banks. She said in 2014 there was a new segment added to the QBP that focuses specifically on 92% of FDIC institutions that meet the community bank definition. Ms. Ellis stated that during the three plus years of reporting on the community bank industry, some important trends have been identified regarding profitability, balance sheet structure and credit quality. She said the presentation today would focus on these trends. Ms. Ellis also welcomed any feedback from the Committee. Ms. Ellis then introduced Ms. Hanrahan to discuss post-crisis community bank performance and outlook.

Ms. Hanrahan said the trends the presentation would focus on were profitability, funding, structure, credit quality, loan growth, market valuations, and market perceptions and the outlook. Ms. Hanrahan then directed the Committee to a slide deck to guide the presentation. She pointed to page 2 of the slide deck which was a chart that demonstrated community bank profitability has largely recovered, but not yet to pre-crisis levels. Member Howard asked what the definition of community bank was. Ms. Hanrahan said that the FDIC utilized a definition since 2012 that takes into consideration the loan to asset ratio, the deposit to asset ratio, how many branches they have, how many MSAs they were located in, and banks that are truly meeting the needs of the community they serve. Turning back to slide 2, Ms. Hanrahan pointed out that while community bank’s pretax return on assets trailed the industry, the reason is that the larger institutions can rely on other sources (non-interest) of income whereas a community bank receives most of its income from interest.

Ms. Hanrahan next turned to slide 3, which illustrates the weighted average efficiency ratio. She said this tends to demonstrate that since the crisis, community banks have been consistently cutting costs and improving their revenue stream. Ms. Hanrahan then turned to slide 4, which describes net interest margin. She noted that while community banks net interest margin is considerably higher than the industry – the gap between the two is beginning to tighten. Part of that reason, Ms. Hanrahan explained, is that as interest rates go up, the larger institutions will benefit more from that environment (large banks are not as long out on the maturity yield curve as community banks, so they can re-price their assets more quickly than community banks). Next Ms. Hanrahan moved to slide 5, which describe funding and asset maturities. Specifically, that community banks report a growing “repricing gap” between assets and liabilities that mature in more than three years. Turning to slide 6, Ms. Hanrahan made the point that community bank credit quality has returned to a very strong position since the crisis. She said this improved credit quality allows community banks to lend. Ms. Hanrahan illustrated this point by referring to slide 7, which shows that as non-current loans to total loans rate goes down, the level of merger adjusted annual loan growth increases. Continuing on the topic of loan growth, Ms. Hanrahan utilized a chart on slide 8 to illustrate that community bank loan growth has exceeded growth at non-community banks for five consecutive years. She utilized slides 9 and 10 to describe that in 1-4 family mortgages and CRE loans, community banks consistently lead non-community banks in terms of merger adjusted growth in real estate loans and while large banks tend to dominate consumer lending, community banks have led growth in commercial and industrial lending for the past four years. What this means Ms. Hanrahan said, is that community banks devote a large and growing share of their balance sheets to lending. She utilized slide 11 to make the point that loan growth for community banks has returned to pre-crisis levels. She referred to a chart on slide 12 to emphasize that while the community bank

share of industry loans fell by half between 1987 and 2007, it has stabilized in the post-crisis period. What this has translated to, she explained, is that the industry's average price-to-book ratio has recently surged higher with the rise in bank and thrift equity prices.

Ms. Hanrahan summed up the presentation by referring to slide 14 and made the following points: the community banking sector is performing well and expanding its lending; net interest margins and profitability remain squeezed in the slow growth, low-rate environment; a gradual transition to higher interest rates and faster economic growth would help restore profitability; rising price-to-book premiums signal new optimism about profitability and new de novo banks. She described the following emerging risks: institutions with mismatched portfolios could be vulnerable to a rapid rise in interest rate or outflows of deposit funding; a large decline in the value of richly-priced equities and real estate could push credit losses higher; rapid increases in CRE financing could indicate rising credit risks in some markets. Ms. Hanrahan then welcomed any comments or questions from the Committee.

Member Baer Paine asked to what extent non-banks (mortgage lenders) are factored into the analysis. Ms. Hanrahan answered that it is somewhat difficult to get that information since many are not publically traded. Member Howard commented that in the State of Connecticut, Rocket Mortgage has gone from non-existent to either number one or two in market share in three years. Research performed on them reveals that they are not really offering anything different from what his Bank is offering, the difference being the way that they package it and sell it. Member Howard then continued to express another concern with respect to the historical "sticky-ness" of deposits as interest rates increase. Ms. Hanrahan agreed that is one of the FDIC's concerns as well and she hoped that banks are doing more than one deposit run off scenario when they look at their interest rate risk model.

Member Turner commented that an article he recently read described the country's gross domestic product ("GDP") as growing at around 2% per year while loans on bank's balance sheets are growing at round 8-9% per year -the premise of the article being that loan growth is too fast. Member Turner then asked if this is something that the FDIC considers. Ms. Hanrahan responded that the FDIC does not necessarily view the loan growth (in comparison to the GDP) as per se negative. She added that the agency focus is more on whether the lending is done in a safe and sound manner.

Member Hanrahan thanked the panel for the presentation and commented that it is particularly helpful to receive credible, unbiased information.

Ms. Ryan then introduced the last panel to discuss supervisory policy issues. Ms. Ryan introduced Mark Pearce, Director, Division of Depositor and Consumer Protection ("DCP"), Jonathan Miller, Deputy Director, DCP, and Rae-Ann Miller, Associate Director, RMS.

Mr. Miller then began by discussing flood insurance. He said that in November of 2016 the FDIC along with the OCC, the Federal Reserve, Farm Credit Administration and the National Credit Union Administration issued a proposed rule on private flood insurance regarding dealing with the Flood Insurance Reform Act, specifically the proposed rule would require regulated institutions to accept policies that meet the statutory definition of flood insurance in the Act and also permit lenders on a discretionary basis to accept private flood policies provided that those

insurers meet certain conditions. Mr. Miller said that the agencies also proposed a provision that would allow the regulators to accept flood insurance coverage issued by mutual aid societies if those mutual aid societies met certain standards (set out in more detail in the proposal). He said that the agencies received 60 written comments on the proposed rule primarily from the lending and insurance industries. Mr. Miller reported that the agencies are currently going through the comments and hopefully looking to finalize a rule by the end of the year.

Mr. Miller next discussed the interagency questions and answers (“Q & As”) on flood insurance. He said that as part of the EGRPRA process, a number of comments were received about the flood insurance program and requests to update the flood Q & As. Mr. Miller said as result of the numerous changes to flood insurance over the past several years there is currently an inter-agency effort to update the flood Q & A’s, focusing on the changes that resulted from the Biggert Walters Flood Reform Act of 2012 and the Home Owner Flood Affordability Act of 2014. Mr. Miller reported that good progress has been made on the revised Q & A’s and the agencies should be on track to publish them in the early part of 2018.

Mr. Miller next discussed the Home Mortgage Disclosure Act (“HMDA”). He said that in 2015 the CFPB issued a final HMDA rule to amend regulation C (which is the implementation regulation for HMDA). Mr. Miller reported that as a result of the rule (the higher reporting thresholds), about 550 additional FDIC supervised institutions no longer have to report HMDA data. He said this leaves just over half of FDIC supervised institutions not having to report flood data and the remaining FDIC institutions that do have to report flood data will have to report more data. Mr. Miller indicated that at the FDIC, the focus has been how the agency can be more helpful to community banks as they work to implement the rule. For example, Mr. Miller said that the FDIC will be hosting a banker teleconference in 2017 focused on HMDA implementation topics which will address any concerns about the HMDA changes. Mr. Miller also stated that the FDIC is working with other agencies including the CFPB to monitor HMDA implementation activity to understand and anticipate issues that may arise as banks prepare for the rules’ new requirements. He said this work includes a focus on any questions or challenges community banks may be facing as they update their processes and systems as well as issues regarding support being provided by third party vendors. Mr. Miller added that regarding third party vendors, the CFPB is having periodic meetings with a HMDA vendor working group and the FDIC is participating in those meetings. He said that the FDIC is also working to identify other vendors that are primarily serving smaller banks with the goal of hearing from them on what they are doing to prepare for HMDA implementation. Mr. Miller welcomed any feedback from the Committee on this issue.

Mr. Miller next stated that traditionally each FFIEC agency has established its own HMDA transaction testing guidelines for its examiners to apply in evaluating the integrity of the institution’s HMDA data and determining whether to direct an institution to correct and re-submit HMDA data. He said with the new HMDA rule, the FDIC has been working closely with the CFPB, OCC, Federal Reserve, state regulators, and the NCUA to look for opportunities to coordinate and increase consistency in the approach to validating the integrity of the HMDA data. Mr. Miller added that, as with interagency discussions generally, agency staff will consider the relative differences among institutions in HMDA reporting. (Side note: FDIC supervised institutions on average originate fewer than 100 first lien mortgages per year).

Next, Mr. Miller discussed the Community Reinvestment Act (“CRA”). He said over the past several years the FDIC, OCC, and Federal Reserve have been working to update CRA guidance in a number of ways. Mr. Miller noted that the agencies have adopted new and revised Q & A’s twice in the past several years to clarify agency practices in CRA evaluations. He noted that in 2013, the agencies clarified how community development activities in the broader statewide regional areas that include the banks assessment area will be considered in the CRA performance evaluation. Similarly, Mr. Miller said that in recognition of the increased role that alternative delivery systems play in delivering financial products and services to consumers, the agencies adopted a new and revised Q & A in 2016 to encourage banks to provide retail products and services through such alternate delivery systems such as through mobile phones. Mr. Miller added that the FDIC has taken a particular interest in this in an effort to expand economic inclusion. He said the agencies have developed comprehensive training materials to improve implementation of the new guidance and to communicate how these revisions to the CRA Q & As will affect the consideration of CRA activities. Mr. Miller stated that this training was provided to the examination staff of all the agencies and to the public generally, to the financial services industry, community based organizations, local governments and other interested parties. He added that financial institutions are always welcome to discuss any questions they may have regarding CRA with their examiners, regional compliance staff or community affairs officers.

Next Mr. Miller discussed CRA examination procedures. He said that the FDIC and the other banking agencies are committed to reviewing and updating CRA exam procedures to ensure greater consistency in performance evaluation and ratings across the agencies. Mr. Miller noted that one comment heard from non-profit stakeholders, non-profit community organizations and financial institutions, is the need for consistency in CRA evaluations both within regulators (from one region to another) and among regulators. He said that as a result, the agencies have embarked on a comprehensive rewrite and update of the CRA exam procedures to improve the quality and consistency of examinations both within each agency and on an interagency basis. Mr. Miller added that the revisions and updates will incorporate guidance issued since the procedures were originally published and identify and address inconsistencies where possible. He said that it is anticipated that the revisions will include updated procedures, explanatory materials and instructions on how examiners should conduct the evaluation.

Before concluding, Mr. Miller noted that there is a CRA notice of proposed rulemaking coming up in the next several months. He said the purpose of the rulemaking is to conform certain definitions that have been changed as result of the HMDA rule. Mr. Miller then turned the discussion over to Ms. Miller.

Ms. Miller began by reporting that last month the FDIC adopted existing supervisory guidance on model risk management. She said this guidance was last issued by the OCC and the Federal Reserve in 2011. Ms. Miller indicated that the reason the FDIC joined was that certain larger institutions supervised by the FDIC had increased their reliance on models. She explained that it was the FDIC’s view that it was important to adopt the guidance to facilitate model risk management expectations across the banking agencies and the industry as a whole. Ms. Miller stated that the guidance defines a model as a “quantitative method, system or approach that applies statistical economic financial or mathematical theories techniques and assumptions to process input data into quantitative estimates.” Member Howard asked if the guidance covers

models that third parties would provide to the bank. Ms. Miller responded that the guidance does cover third party model validation process and performing proper due diligence.

Ms. Ryan then welcomed any comments or discussion from the Committee. Member Howard commented that he was encouraged to hear the amount of attention being paid to consistency with HMDA data. He pointed out that with more data there is more chance for error.

Member Turner asked if there was a discussion of the tolerance rates regarding re-submission. Mr. Miller responded that the issues are being discussed and the agency hopes to have something soon. Mr. Pearce added that a fresh approach is being taken with the new HMDA rule. Mr. Pearce further explained that the considerations will include how accurate the data needs to be for supervisory purposes and market monitoring and what kind of approach needs to be taken to reach that level of accuracy.

In bringing the meeting to a close, Chairman Gruenberg commented that it was an excellent meeting and welcomed any comments or feedback from the Committee on any of the topics presented, specifically the work being done on the examination process. Member Beard commented that at the University of Utah, there is an institute called the Lassan Institute and its purpose is to take an academic view of developing issues in banking. He mentioned that it might be useful if banking related issues could be subject to academic study (in contrast to a regulatory study), where data could be analyzed independent of politics. Member Beard said that collaboration with the FDIC might be very useful and informative to the banking industry. Chairman Gruenberg commented that he thought that the idea would be very helpful. He further indicated that he would mention the concept to Ms. Ellis for possible future collaboration.

Chairman Gruenberg commented that the Committee continued to be a great resource for the FDIC and thanked the members for their participation.

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There being no further business, the meeting was adjourned at 3:00 p.m.

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

July 12, 2017

Minutes  
of the  
Meeting of the FDIC Advisory Committee on Community Banking  
of the  
Federal Deposit Insurance Corporation

Held in the Board Room  
Federal Deposit Insurance Corporation Building  
Washington, D.C.

Open to Public Observation

July 12, 2017 – 9:00 A.M.

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

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