Minutes

of

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

January 20, 2011 8:39 - A.M.

The meeting of the FDIC Advisory Committee on Community Banking ("Committee") was called to order by Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation ("Corporation" or "FDIC") Board of Directors.

The members of the Committee present at the meeting were: R. Daniel Blanton, President and CEO, Southeastern Bank Financial Corporation and Georgia Bank & Trust Company of Augusta, Augusta, Georgia; Dorothy J. Bridges, President and CEO, City First Bank of D.C., Washington, D.C.; Charles G. Brown, III, Chairman and CEO, Insignia Bank, Sarasota, Florida; Deborah A. Cole, President and CEO, Citizens Savings Bank and Trust Company, Nashville, Tennessee; Craig M. Goodlock, Chairman and CEO, Farmers State Bank, Munith, Michigan; James H. Gray, Chairman, Beach Business Bank, Manhattan Beach, California; Jack E. Hopkins, President and CEO, CorTrust Bank, National Association, Sioux Falls, South Dakota; Timothy W. Koch, Professor and Chair, Finance Department, Moore School of Business, University of South Carolina, Columbia, South Carolina; John P. Lewis, President and CEO, Southern Arizona Community Bank, Tucson, Arizona; Jan A. Miller, President and CEO, Wainwright Bank & Trust Company, Boston, Massachusetts; Rebecca Romero Rainey, Chair and CEO, Centinel Bank, Taos, New Mexico; Bruce A. Schriefer, President, Bankers' Bank of Kansas, National Association, Wichita, Kansas; Laurie Stewart, President and CEO, Sound Community Bank, Seattle, Washington; Ignacio Urrabazo, Jr., President, Commerce Bank, Laredo, Texas; and

Matthew Williams, Chairman and President, Gothenburg State Bank & Trust Company, Gothenburg, Nebraska.

Members of the FDIC Board of Directors present at the meeting were: Sheila C. Bair, Chairman; Martin J. Gruenberg, Vice Chairman; John E. Bowman, Acting Director of the Office of Thrift Supervision ("OTS"); and Thomas J. Curry, Director (Appointive).

Corporation staff who attended the meeting included: Willa M. Allen, Ruth R. Amberg, William R. Baxter, Michelle M. Borzillo, Luke H. Brown, Richard A. Brown, Jason C. Cave, Glenn E. Cobb, Christine M. Davis, Patricia B. Devoti, Joseph A. DiNuzzo, Doreen R. Eberley, Diane L. Ellis, Robert E. Feldman, Ralph E. Frable, Steven D. Fritts, James J. Gallagher, Alice C. Goodman, Shannon N. Greco, Tray Halverson, Nancy W. Hunt, Michael L. Jackson, Kenyon T. Kilber, Ellen W. Lazar, Gil A. Ledbetter, Alan W. Levy, Cassandra McConnell, Roberta K. McInerney, Robert W. Mooney, Tariq A. Mirza, Arthur J. Murton, Paul M. Nash, Christopher J. Newbury, Thomas E. Nixon, Richard J. Osterman, Jr., Kent D. Oz, Mark E. Pearce, Grace Pyun, Carolyn D. Rebmann, Claude A. Rollin, Barbara A. Ryan, Jon T. Rymer, Robert F. Storch, Jesse O. Villarreal, Cottrell L. Webster, Bucky Wells, Mindy West and Katherine G. Wyatt.

William A. Rowe, III, Deputy to the Chief of Staff and Liaison to the FDIC, Office of the Comptroller of the Currency; and Charlotte M. Bahin, Senior Counsel for Special Projects, OTS, were also present at the meeting.

Chairman Bair opened the meeting by welcoming the Committee members and providing an overview of the day's topics, including: an FDIC study about core and brokered deposits; the Treasury Department's new Small Business Lending Fund program; the FDIC's efforts to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"); emerging risks for the banking industry; an introduction of Mark Pearce, Director of the FDIC's soon to be launched Division of Depositor and Consumer Protection ("DCP"); regulatory burden relief; and a roundtable discussion. She noted that Jeffrey Goldstein, Undersecretary of the Treasury for Domestic Finance, would provide remarks during the luncheon. Chairman Bair noted that the FDIC hosted a forum the previous week on small business lending issues, and she then provided an overview of that forum's speakers and topics.

Chairman Bair observed that the day's focus was to inform Committee members about the FDIC's thinking on significant community banking issues and to obtain their input on them. She introduced Paul M. Nash, Deputy to the Chairman for External Affairs, who coordinated the agenda.

Mr. Nash introduced Diane L. Ellis, Deputy Director, Financial Risk Management and Research, Division of Insurance and Research ("DIR"), Melinda West, Chief, Policy and Program Development, Division of Supervision and Consumer Protection ("DSC"), and Joseph DiNuzzo, Supervisory Counsel, Assessments, Legal Division, who spoke about "Brokered Deposits/Core Funding Issues." Ms. Ellis indicated that the Dodd-Frank Act required the FDIC to complete a study about core and brokered deposits by July 21, 2011. She stated that existing deposit rules, particularly brokered deposit rules, might have become obsolete; that the FDIC was looking for a better way to view deposits for supervisory and assessment purposes; and an idea was to classify deposits along a spectrum, from stable to potentially volatile.

Ms. West then inquired how members would weigh various bank funding stability characteristics such as: customer relationships; deposit size and whether it was insured; whether the deposit was local or not; and whether the interest paid on the deposit was above rate.

Member Urrabazo observed that the geographic source of deposits can play a key role; his Texas bank had many deposits from Mexico, some over a million dollars, and that those deposits often raised a rate sensitivity analysis issue during examinations. He stated that he gathered information over the years that showed that the deposits were stable. Member Brown discussed his bank's experience with remote deposits, noting that although many of them are not local, his bank's policy of maintaining close contact with remote deposit customers meant that many such deposits could fairly be considered core. Member Gray later provided an example of how his bank had developed long-term banking relationships with doctors across the country using remote capture technology. Member Stewart added that, in her view, geography is less significant among consumer accounts as well as business accounts. Her bank found that the most important retention factors were the number of services used by the customer, especially electronic services, and that geography was not as important. Member Miller discussed an example of a stable brokered deposit. Specifically, his bank had accepted multi-year certificates of deposit through a brokered network

that paid lower interest rates than the rate offered by the bank within their local area.

Ms. Ellis observed that a theme appeared to be developing that the customer relationship should be heavily weighted, and might overcome other characteristics that might otherwise be indicative of a less stable deposit. She asked about the impact of technology on deposit stability; for example, if Internet sourced deposits were more or less stable than "in-person" deposits. Members Miller and Bridges shared their mission-driven banks' experiences in attracting deposits using magazine advertisements and the Internet. The banks' experiences indicated that such mission-driven deposits, made convenient by newer technologies, were long-term and stable, even if they were brokered deposits.

Member Schriefer opined that transaction accounts by definition should be viewed as mostly core deposits. Member Gray said that it is important to consider the bank's business plan when thinking about interest rates and deposit stability. His bank offered a business savings account that paid a slightly higher interest rate than a regular savings account. The accounts had been successful and allowed the bank to reduce its brokered deposits.

Member Brown indicated that outside rating agencies' ratings of banks can affect the stability of deposits, especially those above the insured amount, because the ratings can affect the public's perception of bank-failure risk. Chairman Bair observed that a current goal was to determine what might happen to different deposits if the public perceived a bank was weakening. She continued that, for insurance premium purposes, the FDIC needed metrics that could be included in the Call Report, and inquired about information banks maintained regarding deposits. Member Cole described various deposit characteristic information that her bank keeps, including length of time of deposit and average deposit size. Member Goodlock reported that his bank maintains substantial data about deposit relationships but cautioned that relatively few community banks do. He suggested that there should be a mechanism by which smaller banks that did not track information would be allowed to rely on more general information in order to have their deposits classified as stable. Later, Ms. Ellis noted that if the FDIC changed its approach to analyzing deposits, it would need additional or different bank data, and that any data collected on the Call Report could not be very nuanced.

The Committee then discussed deposit stability as it relates to reciprocal deposits. Member Blanton stated that his bank had a surplus of deposits, and that it used reciprocal deposits to ensure that all of the deposits were insured. Members Hopkins, Williams and Blanton indicated that their opinion was that reciprocal deposits should be viewed as stable deposits rather than brokered because the customers for whom they are used are among a bank's most stable. Member Gray noted that many entities that have fiduciary responsibilities make use of the Certificate of Deposit Account Registry Service ("CDARS") program and that it was easy to document such purposes.

In response to a question from Member Williams, Ms. Ellis described how the FDIC distinguishes between reciprocal CDARS and traditional brokered accounts for insurance premiums. Chairman Bair stated that she understood that CDARS could be used to support stable deposits, as the Members reported, but that she was also aware of CDARS being used in ways that did not promote deposit stability. The problem, she indicated, was differentiating between the two uses.

Member Hopkins cautioned against tying insurance premiums to geographic territories because, he stated, community banks would be disadvantaged when compared to large banks' whose territories are the entire United States. Member Koch suggested viewing deposit stability in an economic sense rather than a definitional one; a bank should be able to estimate the interest elasticity for all of its funding sources so that, when interest rates change, it can estimate what deposits would flow in and out.

In response to a question from Member Schriefer, Ms. Ellis stated that in the recent downturn, institutions that failed were about twice as likely to have brokered deposits as banks that didn't fail, and failed institutions funded between two and three times as much with brokered deposits as non-failures. Responding to comments from Members Miller and Hopkins, Vice Chairman Gruenberg agreed that risky lending often plays an important role in the failures, but added that brokered deposit concentrations contributed to liquidity failures. Chairman Bair later observed that the FDIC often has to pay off brokered deposits in failed banks because there is little acquirer interest in them. Ms. Ellis added that the FDIC's loss rate in failed banks with brokered deposit concentrations was about one and one-half times the average.

Member Stewart provided a suggestion to reduce the burden on some banks of reporting specific data to establish deposit stability. The FDIC could establish thresholds for certain metrics (such as the deposit ratio, percentage of brokered deposits) and, if a bank fell below that threshold, it would not be required to provide further data. If a bank missed a threshold, she added, it could take steps to demonstrate the deposits' stability.

Member Urrabazo had earlier expressed the view that a bank's payment of premium interest rates was often an indicator of CDARS being used in a way that did not promote deposit stability. He suggested that examiners should question such banks about their rationale for exchanging CDARS. Chairman Bair later stated that there appeared to be agreement that paying above market interest rates was a risk condition, but asked how above market rates could be defined given geographic differences and other factors. Member Schriefer suggested making a tie between the cost of funds to Treasuries; however, Member Hopkins indicated that his bank would have a problem with that approach because it shares a market with credit card banks and their geographic market is historically above market. Ms. West stated that, once a bank becomes less than well-capitalized, it is restricted from paying above market rates. She further noted that the FDIC published a national rate to avoid a Treasury rate tie because it was so low and penalized many banks. Member Urrabazo observed that local deposits are more expensive than funding from home-loan banks, and that community banks must balance the stability of local deposits against their cost.

Member Brown shared an example of a new bank, without problem assets, that had to curtail its lending due to sensitivity to paying over-market rates; he commented that it was important to distinguish between such banks paying above market rates and banks that are troubled by a liquidity crisis. Chairman Bair responded that such a distinction underscored how difficult it is to calibrate the issue correctly and noted the additional issues of identifying easily reportable metrics that do not impose excess regulatory burden. Members Blanton, Urrabazo, Bridges, Cole, and Williams discussed the challenges of developing a guideline in light of conflicting goals. Member Brown inquired whether the regulatory agencies had discussed expanding the number of CAMELS ratings from five to ten, and Chairman Bair responded that the FDIC favored a comprehensive review of the CAMELS process.

Mr. Nash then introduced Jason Tepperman, Director of the Small Business Lending Fund ("SBLF"), Department of Treasury, and Steven D. Fritts, Associate Director, Risk Management Policy and Examination Oversight Branch, DSC, who spoke about "Small Business Lending." After noting that small businesses are more dependent on bank lending than larger businesses and that community banks are a backbone of small business lending, Mr. Tepperman provided an overview of the SBLF program, a $30 billion capital initiative designed to work with community banks to expand small business credit availability. He stated that banks with assets of $10 billion or less may participate; and banks under $1 billion may receive up to five percent of risk weighted assets from the program, while banks between $1 and $10 billion may receive three percent. Mr. Tepperman stated that the dividend rate that banks must pay for the funds would start at no higher than five percent. He then described how the dividend rate could be adjusted lower quarterly as banks increased their amount of small business lending. Specifically, if banks increased their small business lending by ten percent over the baseline lending amount (calculated as the average amount in the four quarters ending in June, 2010), the dividend rate could be as low as one percent. Mr. Tepperman added that, after two years, the dividend rate would be locked in for the next two and a half years. He explained that the purpose of this was to encourage banks to make their best effort to find credit-worthy borrowers and extend credit in the near term. After the four and one-half year period, he indicated, participating banks would pay a nine percent dividend rate.

Mr. Tepperman stated that the SBLF program defined small business lending so as to cover much of the business lending that community banks engage in, including: commercial-industrial, owner-occupied commercial real estate, agricultural production finance, and farmland loans. He said that loans over $10 million, or to businesses with over $50 million in revenue, would not qualify for the program. Mr. Tepperman stated that banks could use SBLF funds to refinance preferred stock that had been previously issued to the Treasury in earlier programs. He indicated that the one page program application was on the Treasury website. Banks would also have to provide a short, small-business lending plan that Treasury would share with the bank's regulator.

Mr. Tepperman and Mr. Fritts described the regulator's consultation role. Mr. Fritts stated that the FDIC will provide Treasury with a bank's current supervisory information; it would also review the bank's lending plan for safety and soundness

purposes, and evaluate whether it was realistic given the bank's overall supervisory condition. He added that the FDIC had been asked to consult with Treasury on 48 applications. Mr. Fritts stated that the banking agencies would provide information but that Treasury would make the application and investment decisions.

Member Brown complimented the SBLF program application as easy to understand and complete. In response to questions from Member Bridges, Mr. Tepperman described how banks that had Capital Purchase Program ("CPP") money could transition to the SBLF program. He also described how banks that were found ineligible to participate in the program on first review would be entitled to a second review for possible SBLF investment, if the bank were to raise a matching private capital investment. In response to a question from Member Schriefer concerning the payback of SBLF money, Mr. Tepperman noted that the capital could be perpetual and discussed methods by which program funds could be repaid. Responding to Member Brown, Mr. Fritts indicated that Treasury would evaluate a bank's repayment ability.

Responding to Members Bridges and Blanton, Mr. Tepperman clarified that the underlying legislation did not allow for the inclusion of wholesale loan purchases or loan participations, and that non-owner occupied commercial real estate was not eligible for the program. Member Schriefer observed that a program requirement that small business borrowers certify that they had not been convicted of a sex crime appeared not germane to SBLF, and asked if it would be applied to all bank lending applications. Mr. Tepperman noted that the certification requirement had been added later in the legislative process and that Treasury was working on how to implement the requirement in a commercially reasonable way.

In response to a question from Member Lewis, Mr. Tepperman reviewed how the SBLF program related to Small Business Administration loan programs. In response to questions from Member Stewart, Mr. Tepperman indicated that the terms sheets for mutual banks and Sub-chapter S corporations had not been completed, but that he saw no reason why they would not be able to participate in the SBLF program.

The Committee and panelists discussed what bank types would find the SBLF program attractive. Mr. Fritts observed that the program could be attractive to banks that have CPP money, and are in stable condition, but are having difficulty acquiring

new capital. He added that the program could be financially attractive to banks whose lending increases would lower the cost of SBLF funds to one percent. Mr. Tepperman stated that, although Treasury did not have its own projections, he had seen investment bank models which predicted 20-30 percent earnings improvements for banks that lowered their SBLF rates to one percent.

Mr. Nash inquired about an apparent regional variation in SBLF interest. Mr. Blanton, from Georgia, indicated that his bank would have to greatly increase its small business lending just to reach the baseline figure specified in the program before the SBLF dividend rates would be reduced, and opined that his market did not have sufficient loan demand. Chairman Bair observed that it was an unfortunate outcome of the program that banks that had kept their loan balances relatively high during the economic crisis would find them harder to grow in the SBLF program. Member Goodlock, of Michigan, stated that there was a dearth of qualified borrowers in his market. Member Brown indicated that the SBLF program was more attractive in Florida, where there was growing loan demand but limited access to capital. Responding to Member Hopkins, Mr. Tepperman stated that no SBLF applications had been approved yet but that approvals and early funding should occur soon.

The Committee stood in recess at 10:21 a.m. The meeting reconvened at 10:43 a.m. that same day.

Ms. Alice C. Goodman, Deputy Director of the Office of Legislative Affairs, and Ms. Ruth R. Amberg, Senior Counsel, Consumer/Compliance Section, Legal Division, provided the Committee with an "Update on Dodd-Frank Implementation." Ms. Goodman noted that the FDIC was aware that there was uncertainty among community bankers about the actual language of regulations and about the new Consumer Financial Protection Bureau ("CFPB"). She observed that community banking had received some accommodations in the legislation, such as the treatment of trust preferred securities, and an exception for the executive compensation rule. Ms. Goodman invited the Committee to provide their views on a variety of subjects, as discussed below.

Ms. Amberg described various rulemakings and other projects in which the FDIC was engaged. She noted that many of the implementation efforts had been about systemic risk mitigation and deposit insurance reform, neither of which imposed much burden on community banks. Ms. Amberg discussed proposed and final rules that have already been published, and then those

that would be addressed in the next several quarters. She noted that the FDIC provided the public with easy access to all the initiatives at www.fdic.gov/regulations/reform/initiatives.html. Ms. Amberg noted that, pursuant to the FDIC's transparency policy, the FDIC posted information about who had met with whom about rulemakings and the nature of their comments.

In response to a question from Member Stewart, FDIC staff and Committee members engaged in a sustained discussion about the role of public comments on FDIC rulemaking. Mr. Nash said that, before he started working at the FDIC, he had shared Member Stewart's uncertainty whether public comments had much effect, but that he had since seen that every comment is reviewed and summarized, and FDIC leadership is briefed about their content. Ms. Goodman added that Board members asked many questions about public comments. Ms. Amberg observed that staff reviews the comments carefully to identify possible changes to proposed rules that could be recommended to the FDIC Board. Responding to Member Urrabazo, Ms. Goodman and Ms. Amberg discussed the FDIC's practice of summarizing the public comments when it publishes a final rule. Member Urrabazo suggested that the summaries might be more useful if they provided additional characterization about comment trends the FDIC observed.

Member Goodlock suggested that Committee members encourage other community bankers to provide comments on proposed rules. Member Stewart agreed and noted that it is easy for a community banker to assume that, if one person had advocated a point of view they share, that there was no need for them to also comment. Member Blanton stated that his main Dodd-Frank Act concern was the cost of compliance, that the new rules would add another layer of expense. Later, in response to Member Schriefer's inquiry, only one Committee member indicated that their bank had an attorney on staff. Other members depended on outside counsel or non-attorney compliance officers to review new regulations. Member Schriefer observed that there was insufficient time for community bankers to engage in their business and to fully understand the new requirements.

Member Cole indicated that many rules do not apply to community banks by their terms, but that over time, they become "best practices" to which community banks were eventually expected to conform. Member Miller also indicated that the "trickle down" effect of laws to community banks was a problem, as well as the unintended consequences of rules. Member Bridges stated that if a community bank engages in predominantly one type of business, it may still be required to develop policies

and procedures in a business area which has little to do with its usual business. She also later observed that the Dodd-Frank Act legislation was generating a large number of regulations and that community banks had to expend resources to determine which ones were applicable and which were not.

Chairman Bair, Vice Chairman Gruenberg and FDIC staff acknowledged the burdens that new regulations impose on community banks. Chairman Bair observed that every new regulation imposes a higher incremental cost to community banks than on large banks. She stated that the FDIC is sensitive to the fact that the new regulations address issues that arose with large banks, and that the FDIC needs to avoid unintended trickle-down effects on community banks. Chairman Bair indicated that the FDIC has an interest in community banks having greater balance sheet diversification and expressed concern that new rules, if overbroad, might discourage banks from entering new areas of business or growing smaller ones. Vice Chairman Gruenberg recognized that, even though many of the new rules do not impact community banks, there is significant effort involved for smaller banks to sort through the many publications in order to make those determinations.

Member Rainey suggested that the FDIC might initiate conference calls for community banks when rules are published to draw attention to the rule and explain the intentions behind the rule. Such conference calls, she indicated, might help avoid bankers being misled by consultants about a rule's purpose or impact. Member Goodlock agreed that such calls would be helpful. Member Gray suggested that, when the FDIC established a new regulation, it could also establish a safe-harbor type general policy that banks could follow if they chose.

Members and staff discussed ways to clarify what rules did not apply to community banks. Member Bridges observed that a statement in a rule that it applied to banks with "over $10 billion in assets" but was silent regarding banks under $10 billion, allowed for subsequent interpretation and expansion to smaller banks. She and Member Miller suggested that an explicit statement that such a rule did not apply to smaller banks would help avoid future trickle-down effects. Later, Member Stewart suggested that, when communicating about new rules, the FDIC could provide standardized executive summaries that included a table showing the size banks to which the rule applied. She observed that such a standardized table could help community banks prioritize their rule reviews, direct rules to the most appropriate screeners, and generally increase efficiency.

Chairman Bair agreed that executive summaries were helpful and could also be used by the FDIC.

Earlier, Member Goodlock inquired about what influence the FDIC would have with the CFPB and the consumer protection rules the CFPB would write. Ms. Amberg noted that the law requires the CFPB to consult with the FDIC as part of its rulemaking process. Chairman Bair indicated that the CFPB Director would be a member of the FDIC's Board and should come to understand community bank concerns through that role. The Chairman also suggested that the FDIC might assist the CFPB by formally analyzing new CFPB rules for their impact on community banks.

Responding to Member Gray, Ms. Amberg indicated that it was not yet known how many new or revised bank policies would be required by Dodd-Frank Act regulations, although she expected that few would be required. Member Gray observed that revising bank policies (as well as writing new ones) required bank resources. Mr. Nash encouraged Members to contact the FDIC when they saw potential trickle-down effects in rules. Chairman Bair concurred, adding that the FDIC tries to be sensitive to community bank concerns and could provide comments to other agencies' proposed rules.

Mr. Richard Brown, Associate Director, Regional Operations, DIR, and Ms. Nancy Hunt, Associate Director, Capital Markets, DSC, then spoke about "Emerging Risks." Mr. Brown contrasted how much the risk management perspective had changed from the middle of the last decade, which was viewed as a period of moderation and lowered economic volatility, and the present, in which the economy is dealing with the consequences of a great recession. He observed that, while one must remain cognizant of emerged risks, it is important to focus on emerging risks.

Mr. Brown then reviewed three emerging risks, the first being a possible farmland price bubble. He observed that farmland prices were in the midst of a great boom, and that farmland prices had doubled in nominal terms in ten years. He said that commodity prices are at an historical peak and that the farm sector had earned near record incomes for ten years, but observed that the farm sector is inherently volatile. In evaluating the risk for the banking sector, he stated that farm debt had increased 33 percent in the preceding ten years, but noted that the increase was much less than the quadrupling of debt that had occurred in the early 1980's when a farmland price bubble burst. Mr. Brown observed that most land transactions

involved farmers, rather than investors, and that most farmland is owned without any debt.

The second emerging risk Mr. Brown discussed was the rise in bond prices and lowering of interest rates, and whether that state of affairs could be relied upon to continue. He stated that the large U.S. budget deficit was an important factor and provided a variety of metrics about it and its relation to the gross national product. Mr. Brown observed that the U.S. continues to be viewed as a safe haven but noted that, if it did not address its structural budget imbalances, it might face a sudden and violent loss of confidence resulting in high and volatile nominal interest rates.

The third emerging risk Mr. Brown discussed was state and local finance and municipal debt. He observed that states and municipalities recently experienced sharp revenue drops and that they often responded to such drops by cutting expenditures, including employees. Mr. Brown observed that banks hold about $170 billion of state and local debt, or 6 percent of the total $2.8 billion of such debt. Although historically viewed as a safe asset class, he noted that some (though not all) analysts were predicting severe credit problems. Mr. Brown indicated that recent municipal debt price volatility and the withdrawal of investor funds from the municipal market indicated some uncertainty about the credit quality picture going forward.

Ms. Hunt then described how DSC used macroeconomic analysis information, such as described by Mr. Brown, and combined it with off-site monitoring information and other tools in order to alert examiners and the banking industry about trends that should be considered in risk management. She noted that DSC's interest rate risk advisory about one year before was an example of the process. Ms. Hunt invited the Committee to share their views about emerging risks. Member Gray identified two risks: one was default risk, as exemplified by the municipal "dirt" bonds that Ms. Hunt had earlier described; the other was a mark-to-market risk if interest rates rise, which could have a significant affect on banks' balance sheets.

Member Williams spoke about a possible farmland price bubble and noted that most banks in his agricultural area used cautious underwriting standards, and that most land loans were at about 50 percent of value. He also said that buyers were local farmers, and that investor purchases had virtually stopped. Member Williams indicated that it was important to analyze the long term direction of the food-fiber-fuel demands

and stated that he had an optimistic view. Member Gray observed that some Southern California farmers were repurchasing land for agricultural use that they had previously sold for housing development. Member Schriefer discussed farmland appraisals, noting that they used low (two percent) capitalization rates in their cash flow calculations. Member Hopkins stated that Farm Credit banks had been very aggressive in farmland lending and that this was the biggest driver of a bubble.

Member Williams stated that he favored building reserves in good economic times, such as his agricultural bank was now experiencing. He said that he had been disappointed that, in a recent examination, his bank had been criticized for having a too high loan loss reserve. Member Williams suggested that regulators should support setting aside reserves for potential bubble bursts. Member Blanton agreed, stating that building reserves was prudent business. Ms. Hunt indicated that the matter was the subject of international discussion and involved a conflict of two different accounting approaches about how banks should provision to build reserves for the future.

Member Hopkins observed that interest rate risk was his greatest concern. Member Koch commented about municipal bonds, advising that bankers should generate their own credit analysis based on an extensive credit file as if it was a standard loan, and not rely too much on outside ratings of "investment grade." Relying only on brokers in an area where a community banker has limited expertise is fraught with risk, he said. Mr. Brown agreed that municipal bond quality was very heterogeneous and that ratings might be unreliable. Ms. Hunt added that FDIC's guidance states that banks should perform due diligence and not rely solely on credit ratings.

The Committee stood in recess at 11:59 a.m. The meeting reconvened at 1:56 p.m. that same day.

Noting that the meeting was behind schedule, Mr. Nash recommended taking time from the "Roundtable Discussion" panel at the end of the day since the Committee members had already provided updates about their local economic conditions during lunch. Mr. Nash then introduced Mark E. Pearce, Director of the soon-to-be launched Division of Depositor and Consumer Protection ("DCP"), Luke H. Brown, Associate Director of Compliance Policy, DCP, and Roberta K. McInerney, Deputy General Counsel, Corporate, Consumer, Insurance, and Legislation Branch, who discussed "Consumer Protection and Compliance Issues."

Mr. Pearce noted that, when the FDIC Board of Directors had approved a reorganization last summer, the Board wanted to maintain a strong connection between the risk management and consumer sides of bank supervision. One way to achieve that, he observed, was for Regional Directors to remain responsible for both risk management and compliance so that a single point of contact existed for the oversight of all aspects of insured institutions. Mr. Pearce also discussed two key rationales for creating separate divisions: first, to ensure that there is a dedicated, enhanced, efficient and effective focus on consumer protection issues; and, second, to align the FDIC's responsibilities with the new CFPB. Having noted that he started at the FDIC in November, Mr. Pearce stated that he was taking a fresh look at the FDIC's consumer protection program and invited feedback. In response to a request from Member Schriefer, Mr. Pearce stated that he was trained as a lawyer, had worked in community development on affordable housing finance issues, had been the President of the Center for Responsible Lending, and was later Chief Deputy Commissioner at the North Carolina Banking Commission.

Member Goodlock noted that his bank was primarily a residential lender and stated that he had grave concerns about the CFPB. He said that he hoped that the CFPB would simplify the compliance requirements of the numerous laws that apply to residential lending. Member Goodlock added that he had used a wide variety of financial products over 30 years of banking and that a multitude of tools was necessary to help meet the credit needs of people with limited means and education, as well as the needs of the wealthy and well-educated. Mr. Pearce said that CFPB had announced that one of its first initiatives was to review mortgage disclosure issues, but noted that it would be a challenging project.

Member Brown complimented the FDIC on its risk-based approach in a recent compliance examination at his bank. Regarding spousal signature requirements, however, he noted that the examination appeared to apply a guilty-until-proven-innocent approach, wanting the bank to perform additional analyses that Member Brown viewed as not required by the law. Mr. Pearce responded that, while the Equal Credit Opportunity Act imposes obligations on the FDIC that may have related to the examiner's request, the FDIC had refined its examination procedures to limit the problem described, and said he would look into it further.

Member Urrabazo raised the issue of overdraft programs, stating that there was customer demand for the product, and that more than 80 percent of his bank's customers had opted-in for the program, despite its relatively high cost. Regarding the recent overdraft program guidance, which becomes effective on July 1, he noted that his compliance officer had a long list of issues that were unclear in it, and recommended that the FDIC be more precise. Member Urrabazo, whose bank was currently having a compliance examination, also stated that the examiners had asked to see the bank's written plan for complying with the overdraft guidance although it would not be in effect until July. Member Williams later observed that there had been some question among bankers whether the FDIC was stepping beyond guidance and was writing rules instead. In a similar vein, Member Goodlock asked how much flexibility would be allowed in examinations about overdrafts. For example, he asked, would six overdraft charges in a 12 month period necessarily require the bank to take responsive action or might, in certain circumstances, eight instances be allowed?

Mr. Pearce stated that compliance with the guidance was not expected until July and that this would be communicated to examiners to assure consistent application. He added that the FDIC was more explicit in the guidance about its overdraft program expectations because it wanted to make it easy for institutions to comply; he acknowledged that the specificity caused the guidance to look like a rule. Mr. Luke Brown added that the FDIC had solicited public comment on the overdraft program guidance and received over a thousand letters that had proved very helpful in refining the guidance. He added that the FDIC wanted to provide clear information about what the guidance would mean for each institution, to reduce wasted time and resources.

Chairman Bair noted that overdraft lines of credit are not regulated by the Truth In Lending Act, so that consumers do not get annual percentage rate and other helpful disclosures when overdraft charges are incurred. This lack of disclosures impairs the consumer's ability to understand that they may have lower cost credit alternatives available to them, she said. Chairman Bair indicated that guidance had been in place since 2005 recommending that banks monitor overdraft use and communicate with recurrent overdraft users about alternate products, but that few banks had taken action. Thus, she continued, the new guidance provided greater clarity about the FDIC's expectations about when the communications should occur. The Chairman added that she thought that the most constructive

dialogue would be concerning communications between bankers and recurrent overdraft users: what kind of communication needs to take place; and what consumer responses should trigger what banker responses. She indicated that consumers might choose to continue using overdrafts frequently, but, if they did so after being informed about alternative financial products, it would be better than the present situation, in which overdraft programs had a poor reputation and were the subject of rising consumer complaints.

Member Rainey asked if there would be additional guidance about ad hoc or non-automated overdraft programs. Mr. Pearce, noting that about 70 percent of community bank overdraft programs were ad hoc, confirmed that further guidance would be issued, and would provide clarity on the use of discretion in approving overdrafts. Member Urrabazo compared the ad hoc approval of overdrafts in the past to the current automated overdraft programs, and noted that more consumers were having their overdrafts approved now, thus avoiding merchant charges and possible legal problems associated with returned checks. Mr. Pearce again noted that communication with customers about alternative products was a key point of the guidance.

Mr. Nash then reintroduced Mr. Fritts and Ms. Amberg who spoke about "Regulatory Burden Relief." Mr. Fritts observed that regulatory burden relief posed a challenge, but that the FDIC uniquely understood community banking. He said that the effort was greatly aided due to Chairman Bair's strong support, and that she had instructed FDIC leadership to look in every possible way to reduce burden, to find ways for the FDIC to work smarter, better, more user-friendly, while being extremely cognizant of how FDIC actions impact insured institutions. Chairman Bair, at various points, asked the Committee to identify their burden reduction priorities. Were their main concerns about: existing regulations; Dodd-Frank Act regulations being developed; or overlapping regulations? Or, were their concerns, she asked, focused on specific items such as the Call Report, pre-examination questionnaires, or HMDA reports? Could some processes be further automated using FDIConnect or other methods?

Referring to a previous burden reduction effort (known as "EGRPRA"), the Chairman observed that the FDIC had no control over the language of several burdensome regulations, such as the Bank Secrecy Act and various consumer regulations, and encouraged the Committee to identify efforts where the FDIC could have the most impact. She also noted that any regulatory

change imposed burden, even change meant to ultimately reduce burden, and inquired about the cost-benefit analysis the FDIC should engage in to make its decisions. Chairman Bair repeated her interest in developing a community bank impact analyses for new Dodd-Frank Act rules.

The Committee's discussion included both "big picture" recommendations and discussions of specific topics. Among the general recommendations, Member Stewart, suggested that regulators and bankers might reframe the discussion from "zero tolerance" of any compliance errors, no matter how little impact the error might have on consumers or others, to focus more efforts on regulatory compliance where there was an important impact. Vice Chairman Gruenberg later observed that the point of form over substance was important and that regulatory concern should be focused on identifying things that had a significant impact on people and holding institutions accountable for those. He added that regulators could undercut that objective by being preoccupied with small violations. Chairman Bair stated that the FDIC should set a tone with examiners to focus on meaningful problems rather than technical violations.

Board Member Curry observed that bankers and examiners may not share a common understanding about examination standards and techniques, such as sampling. He suggested that a future presentation by examiners might help explain variations in approaches to different consumer regulations, as well as the consequences of violations. Vice Chairman Gruenberg later agreed that such a presentation could be a useful way to pursue an important issue.

Member Cole suggested that the FDIC foster an environment where bankers feel comfortable questioning an examiner's rule interpretation. This would facilitate robust communications and could lead to a reduction in interpretive mistakes by bankers and examiners, she indicated, after relating an example in which her bank challenged an examiner's troubled debt restructuring ("TDR") interpretation. On several occasions, Chairman Bair and other members of FDIC leadership encouraged Members and bankers to communicate problems and other issues to them. Chairman Bair emphasized that examples of specific problems were especially helpful, and helped to ensure that FDIC policies were being properly implemented in the field.

Responding to Chairman Bair's request concerning burden reduction priorities, Member Goodlock recommended focusing effort on minimizing the burden of regulations and legislation

while they are in development. Member Gray inquired if, when new regulations are written, regulators analyze how the new regulation interacts with existing regulations on related subjects. He expressed the view that such reviews should occur and that a consistent policy among rules should result. Chairman Bair agreed that this would be preferable to merely layering policies on each other, and later observed that some laws needed reconciliation. Mr. Fritts noted that regulations must be drafted consistent with their authorizing statutes which are occasionally inconsistent. Ms. Amberg observed that the CFPB has authority and responsibility to exercise its rulemaking authority in a way that minimizes unduly burdensome regulations on small businesses.

Member Goodlock did not favor adding new lines to the Call Report concerning core deposits because many banks do not maintain the information that would be needed, and the new lines would require new definitions that would be subject to debate. Member Rainey observed that the burden of adding new Call Report lines would be acceptable if it ultimately provided better information for regulators and an easier compilation process for banks. Member Rainey also strongly favored further automating the completion questionnaires and requiring that banks report changes in information only to save time and better focus bankers on changes that might increase risk.

Early in the panel, the Committee discussed some specific issues that members viewed as unclear or burdensome. In response to Member Goodlock, Chairman Bair noted that, while many bankers viewed Home Mortgage Disclosure Act ("HMDA") reporting as unduly burdensome, it did produce valuable information. Although HMDA is one of the regulations that the FDIC does not control, Chairman Bair indicated that the FDIC would be careful to apply a risk focused approach in HMDA examinations.

The Committee also discussed recent interagency guidance on the appraisal regulations. Member Hopkins stated that guidance was causing compliance problems in rural areas. He, Member Schriefer and Mr. Fritts then discussed appraisals, broker price opinions, and independence requirements in performing evaluations. Generally, Mr. Fritts stated that the guidance had not made fundamental changes in appraisal requirements, but had tried to allow the cost-effective use of technological advances, and to allow bankers more flexibility to use alternative valuation methods instead of full appraisals.

The Committee discussed TDRs and difficulties in defining when they existed. Members Blanton and Lewis described experiences with customers seeking loan accommodations and expressed concern that providing assistance would later raise TDR accounting or examination problems for the banks. Member Lewis added that bankers had traditionally helped borrowers through difficult times such as the present, but that potential regulatory criticism of helping made it more difficult to provide that assistance. Mr. Fritts and Mr. Storch clarified that there is a two-step test in determining if a loan modification or restructuring is a TDR. If the borrower is creditworthy, then a modification would not be TDR, they advised. However, if the borrower is experiencing financial difficulties, and a banker grants a concession that would not be granted except for the borrower's troubled condition, then a TDR would exist. Both Mr. Fritts and Mr. Storch observed that judgment had to be exercised, and regulators would look to determine if the bank could show it had consistently applied clear policies concerning the factors it evaluated in making its judgments. Mr. Fritts stated that TDR levels are tracked on Call Reports and that there were not many of them on banks' balance sheets.

Member Williams stated that he agreed with an earlier observation of Member Urrabazo that the FDIC tries to be an advocate for community banking, but noted that many community bankers felt that an adversarial relationship existed. Members Williams, Blanton and Stewart, and Mr. Nash discussed the importance of communications, by the FDIC and the Committee, to dispel misunderstandings. Chairman Bair stated that the common goal was to advance the public interest and that having diversity in banking services and a robust community banking sector is in the public interest. She added that one of the FDIC's roles was to make sure that regulatory policies do not disadvantage one sector over another and to assure public understanding concerning the strength of banks of all sizes. Members Lewis and Urrabzo agreed that communications were important in rebuilding the image of the banking industry. Member Urrabazo added that, if meeting minutes were distributed faster, he could use them as part of his communications when he returned home. Member Stewart suggested that full minutes were probably not necessary, that a quickly published high-level summary would be more helpful.

Chairman Bair had earlier noted that, if the Committee felt strongly about a subject, FDIC staff could assist them drafting a Resolution that the Committee could pass and have transmitted

to the appropriate recipient, such as the CFPB. Member Stewart later indicated that she favored a Committee Resolution as a way to draw the attention of the regulatory agencies and the banking community as a whole to the Committee's views.

Chairman Bair thanked the attendees for their time. Acting OTS Director Bowman stated that he found the meeting very helpful and informative. Responding to Member Lewis, Mr. Nash indicated that the meetings were also very helpful to the FDIC in getting input directly from bankers around the country. As noted above, the "Roundtable Discussion" was not formally convened.

There being no further business, the meeting was adjourned at 3:33 p.m.

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

Minutes

of

The Meeting of the FDIC Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

January 20, 2011 - 8:39 A.M.

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

Sheila C. Bair
Chairman
Board of Directors
Federal Deposit Insurance Corporation

and

Presiding Officer
January 20, 2011, Meeting of the
FDIC Advisory Committee on Community Banking

Dated: April 6, 2011