

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

October 14, 2010 8:38 - A.M.

The meeting of the FDIC Advisory Committee on Community Banking ("Committee") was called to order by Martin J. Gruenberg, Vice 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; 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; 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; and Ignacio Urrabazo, Jr., President, Commerce Bank, Laredo, Texas. Committee members Dorothy J. Bridges, President and CEO, City First Bank of D.C., Washington, D.C.; Jack E. Hopkins, President

and CEO, CorTrust Bank, National Association, Sioux Falls, South Dakota; and Matthew Williams, Chairman and President, Gothenburg State Bank & Trust Company, Gothenburg, Nebraska, were absent from the meeting.

Members of the FDIC Board of Directors present at the meeting were: Sheila C. Bair, Chairman; Martin J. Gruenberg, Vice Chairman; and Thomas J. Curry, Director (Appointive).

Corporation staff who attended the meeting included: Ruth R. Amberg, Michael J. Barry, Valerie J. Best, Michael W. Briggs, Michelle M. Borzillo, Luke H. Brown, Richard A. Brown, Glenn E. Cobb, Kymberly K. Copa, Christine M. Davis, Patricia Devoti, Joseph A. DiNuzzo, Gregory E. Eller, Diane L. Ellis, Michael T. Figge, Ralph E. Frable, Steven D. Fritts, Suzy S. Gardner, Tray Halverson, Nancy W. Hunt, Thomas S. Johnson, Rachel A. Jones, Sally J. Kearney, Kenyon T. Kilber, Ellen W. Lazar, Alan W. Levy, Roberta K. McInerney, Tariq A. Mirza, Arthur J. Murton, Kathleen G. Nagle, Paul M. Nash, Christopher J. Newbury, Thomas E. Nixon, Richard J. Osterman, Jr., Grace Pyun, Claude A. Rollin, Barbara A. Ryan, Christopher J. Spoth, Marc Steckel, Sandra L. Thompson, Jesse O. Villarreal, James C. Watkins, Cottrell L. Webster, and Bucky Wells.

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, Office of Thrift Supervision, were also present at the meeting.

Vice Chairman Gruenberg opened the meeting, noting that Chairman Bair had been delayed but would soon arrive. He observed that the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") had been enacted since the last meeting in April, and that much of the day's agenda would focus on the law's impact on a range of community banking issues. Vice Chairman Gruenberg then introduced Paul M. Nash, Deputy to the FDIC Chairman for External Affairs, who moderated the day's agenda. In turn, Mr. Nash introduced Richard A. Brown, Chief Economist, FDIC, and Associate Director, FDIC Division of Insurance and Research ("DIR"), and James C. Watkins, Deputy Director, Supervisory Examinations, FDIC Division of Supervision and Consumer Protection ("DSC"), who spoke about the "Economic Outlook and Condition of the Industry."

Mr. Brown provided the Committee with an overview of the U.S. economy. He noted that mortgage credit distress is still present, and that foreclosures remain high, though down somewhat from 2009. Mr. Brown continued, noting that there had been some recent stabilization in home prices, but observing that cumulative price declines remain approximately 28 percent below peak levels on average nationwide. He next discussed the index of leading economic indicators, and opined that a double-dip recession appeared unlikely. Nonetheless, he reported that consumer and business confidence remained very subdued and outlined various reasons for that weakness. Mr. Brown observed that the economy had lost substantial jobs in the past decade, including one-third of manufacturing jobs, which makes resolving other economic problems more difficult. He concluded his overview by discussing unemployment and other concerns on a geographic basis, and welcomed the Committee's observations and questions.

In response to questions from Members Urrabazo and Goodlock, a discussion of the Board of Governors of the Federal Reserve System's ("Federal Reserve") anticipated program of quantitative easing followed. In response to a question from Vice Chairman Gruenberg, Mr. Brown also discussed recent developments concerning lenders being unable to document their title in foreclosure and the effect of the resulting uncertainty on credit intermediation. In this regard, Mr. Watkins stated that DSC was closely monitoring the situation, and that the mortgage backed security market had remained stable so far.

At this point, Chairman Bair arrived and began presiding at the meeting.

In response to a question from Member Miller concerning an extended period of stagnation such as Japan's, Mr. Brown discussed the characteristics of recessions that followed financial crises and made observations about differences in the Japanese and U.S. circumstances.

Mr. Watkins then discussed a variety of measures of bank health and supervisory concerns. These included: bank failure rates since the start of the current crisis; asset quality concerns, focused on construction and development, and commercial real estate ("CRE"); underperforming assets and their relation to bank capital; bank earnings, which are weak; and interest rate risk.

The subject of interest rate risk ("IRR") arose at various times during the meeting. Mr. Watkins observed that a rising interest rate environment could cause risk in institutions that had invested in long-term assets at low interest rates. A sudden increase in interest rates, a "shock," would not only affect banks' balance sheets, but would negatively affect the ability of marginal borrowers to repay loans. Mr. Brown added that there were few historical precedents for how the interest rate environment would unfold.

In response to Chairman Bair's request for input from the Committee, Members Blanton, Schriefer, and Brown provided examples of how banks were responding to the interest rate risk and associated supervisory concerns. Member Koch reiterated that IRR caused concerns with net interest income and borrowers' ability to service their debt, and cautioned that banks should be modeling the movement of asset quality down the chain. Member Miller and Chairman Bair shared concerns that, although banks had a good record of responding to a stable interest rate environment, they had not experienced a stable environment at the current low rates. Member Stewart later observed that a concern she had with IRR was its impact on her bank's home equity portfolio, and noted that the bank was assisting customers to refinance their loans into fixed rate loans during this low interest rate period. Mr. Brown stated that, in most recoveries, job growth occurs before interest rates start to rise, but that it is not a guaranteed outcome.

In response to a question from Chairman Bair, the Committee discussed the broader question of weak borrower demand and its causes. Member Blanton indicated that borrowers lacked confidence in the economic recovery to be willing to expand their businesses, and also that many borrowers were tied to real estate in some way and that there was too much uncertainty for them. Member Goodlock discussed borrowers' lack of cash flow, lack of sales, and pessimism about improvements. Member Urrabazo observed that loan demand remained low in Texas and that people wanted to maintain liquidity rather than take risks. Member Gray observed that there was loan demand in his Southern California market, often from borrowers whose loans were not being renewed by larger banks. Member Stewart made consistent observations about her market, adding that her bank also obtained business from failed and merged banks. She observed that community banks were able to modestly expand with high quality credits. Members Urrabazo and Gray also discussed opportunities in Small Business Administration lending.

Later in the meeting, Vice Chairman Gruenberg asked follow-up questions about opportunities for community banks when larger institutions discontinue credit lines. Several members noted that capital constraints limited banks' ability to respond to the demand.

The Committee and staff discussed job growth and factors inhibiting it. Mr. Brown stated that private job growth was slow but steady, but that governments continued to retrench. Members Gray and Cole expressed the opinion that there would not be much job growth until employers' uncertainty about their costs were resolved in areas such as health care, taxes, and financial reform. Member Goodlock indicated he believed that the loss of government jobs was long-term or permanent because of the resistance to higher taxes to pay for them. Members Goodlock and Blanton noted that many regulations still need to be written to implement recent legislation, and that, until the regulations are complete, uncertainty about them will inhibit growth.

The Committee, Vice Chairman Gruenberg, and staff also reviewed the positive relationship between lending concentrations (especially CRE and construction and development lending) and problem bank status or failures. Mr. Brown noted that banks that concentrated in CRE took on greater risk but did not earn a greater return on assets, over the longer term, than banks that did not take on heightened risk. The Committee discussed the effect of troubled European debt on U.S. interest rates; it also discussed mortgage defaults and the existence and timing of "strategic" defaults. At the invitation of Chairman Bair, the Committee provided observations about agricultural lending and potential risks in that market.

The day's second panel regarded "Capital Adequacy and Regulatory Requirements." Mr. Nash introduced Steve D. Fritts, Associate Director, Risk Management Policy Branch, Policy, DSC, and Gregory E. Eller, Deputy Chief Accountant, Accounting and Securities Disclosure Section, Risk Management Policy Branch, Policy, DSC. In his opening remarks, Mr. Fritts provided some relevant statistics to the Committee, noting that capital had been a major issue for community banks and that some had difficulty raising capital.

The discussion turned to the Department of the Treasury's ("Treasury") new small lending capital program, currently in development. Mr. Fritts and Chairman Bair emphasized that the FDIC had only a consultative role in the program but could serve

as a conduit for the Committee's concerns, and noted also that a Treasury representative was in the audience to hear their concerns firsthand. The Committee discussed a variety of issues about the program including: eligibility to participate; the need for clarity and stability in the program's rules; whether there would or should be requirements to expand lending in order to participate; and the definition of what would be considered a small business loan. Several members, including Members Brown, Blanton, and Miller discussed whether the principle of matched funding would be applied. Member Blanton expressed the preference that the program not impose a matching requirement, but that if one was used, that capital raised in the previous two years be grandfathered into the calculation. Chairman Bair observed that the rationale for a matching requirement, if one was used, was to provide a market validation of a bank's viability. She noted that it was Treasury's decision and that the FDIC could help act as a conduit for community bankers' concerns.

In response to a question from Member Schriefer, Mr. Fritts discussed the regulatory treatment of any capital from the program and the need for banks to engage in capital planning since the program was not permanent. The Committee also discussed the interaction of capital planning, trust preferred securities, and section 171 of the Dodd-Frank Act, captioned "Leverage and Risk-Based Capital Requirements," and known as the Collins Amendment. Nancy Hunt of DSC observed that bank holding companies with assets under \$15 billion would be allowed to grandfather trust preferred securities under the new law. Chairman Bair observed that trust preferred securities were debt, not capital, and that there had been correlations between the use of them in certain circumstances and bank failures which resulted in higher deposit insurance premiums.

The Committee discussed regulatory capital. Member Goodlock observed that banks felt that there was some uncertainty on the subject, and that some consultants gave conflicting advice on what regulators expected at examinations. Mr. Fritts advised that the standards did not change except by public changes to the regulation, but that capital levels are commensurate with balance sheet strength and that conditions can worsen. Examiners, he added, exercise judgment regarding the balance sheet and management. Members Goodlock and Blanton gave their views about examiner discretion, suggesting that local examiners may not have enough latitude. Member Brown observed that, over time, bankers and regulators' views about how much

capital was sufficient had changed, and that better communications could increase mutual understanding.

The Committee discussed stress testing. In response to a question from Member Koch, Mr. Fritts noted that management in small community banks do it daily as they monitor the economic conditions in their communities, but that vendor tools could also have a valuable role. Chairman Bair inquired whether bankers felt they would benefit from more specific guidance. She observed that CAMELS ratings tended to be lagging indicators, resulting in the Deposit Insurance Fund ("DIF") reserves tending to lag as well. If regulators made CAMELS ratings more forward looking, stress testing might be considered as a factor, but, she noted, prudent bank management was probably already doing anything that might be required. She invited future input on the subject. Members Goodlock and Brown made further observations about stress testing, noting that some vendors indicated that it was already mandatory, and that inadequate testing models can give a false sense of security. Mr. Nash expressed concern about vendor statements that stress testing was mandatory when that was not the case. Member Koch and Mr. Fritts discussed similarities and differences between vendor stress testing models and the Uniform Bank Performance Report ("UBPR") system that regulators have used for over ten years.

Regarding how much capital banks should hold, Member Urrabazo noted that managers of publicly held banks had to balance the competing interests of regulators and investors, who demanded a certain return on their investments. Chairman Bair flagged for the Committee a developing issue involving the Basel III capital requirements that allowed very large banks to use advanced approaches to risk weight their assets. In the FDIC's view, the advanced approaches did not result in sufficiently robust capital, and she asked for community banking support for rulemaking that would implement protective language.

The Committee turned to additional accounting issues, including mark to market requirements, which Member Gray viewed as very subjective since community banks hold most loans to maturity and there is really no market with which to establish a price. Mr. Eller and Mr. Fritts generally agreed, and Mr. Eller described a joint comment letter that the banking agencies had submitted to the Financial Accounting Standards Board ("FASB") concerning fair value accounting which expressed the agencies' concern about the practical implementation of market pricing on financial instruments such as loans that are held to maturity.

In response to a question from Mr. Nash, Mr. Eller indicated that no specific date had been set for FASB action, but that a deferred effective date would apply to smaller non-public institutions. Mr. Eller also described other current accounting issues for the Committee, including a FASB proposal concerning leasing that might affect capital adequacy requirements. Member Blanton, Mr. Fritts, and Chairman Bair discussed the accounting treatment of banks building reserves relative to expected losses during better economic times. Other issues discussed by the Committee included: the Dodd-Frank Act's effect on credit ratings; new FASB guidance on triple debt restructuring; and dependency ratio requirements in light of the new, higher deposit insurance coverage limits.

The Committee stood in recess at 10:35 a.m.

* * * * *

The meeting reconvened at 10:54 a.m. that same day. Diane L. Ellis, Deputy Director, Financial Risk Management and Research, FDIC Division of Insurance and Research ("DIR"), and Marc Steckel, Associate Director, Financial Risk Management Branch, Financial Risk Management and Research, DIR, led the third panel discussion, titled "The Evolving Deposit Insurance Assessment System," which focused on the Dodd-Frank Act's changes to the management of the DIF. Ms. Ellis reported that based on industry feedback and staff analysis, DIR was preparing several rulemakings, one of which is aimed to allow the FDIC to keep the DIF in the black throughout future economic cycles while charging steady premiums. This would entail, she indicated, a much larger DIF than in the past, with a reserve ratio minimum of about 2 percent. The benefit of doing that, she explained, would be that there could be a steady effective assessment rate of 8 to 8.5 basis points, or about half of the current rate, which would result in a much less pro-cyclical deposit insurance system. Ms. Ellis also discussed other items being developed for the FDIC Board's consideration, including: the terms of a DIF restoration plan; changes to the designated reserve ratio (now 1.25 percent, going to a minimum of 1.35 percent); and a long-term policy about assessment rates and dividends to manage the DIF over the long run.

Mr. Steckel then addressed matters being developed for later Board consideration. He observed that the Dodd-Frank Act changed the assessment base from a focus on domestic deposits to a focus on, roughly speaking, assets less capital, which would generally be beneficial to banks that fund with domestic

deposits. He stated that the FDIC had much implementation work to do, including defining key concepts and terms, and ensuring that the new assessment base continues longstanding policies regarding insurance pricing for banks.

In response to a question from Member Koch, Mr. Steckel discussed efforts to defuse the notion that there are institutions that are "too big to fail," and reiterated that deposit insurance would not be used to support large, uninsured conglomerates. Nonetheless, he observed, there were deposits in some very large, complex companies and that the FDIC was proposing a separate system for assessing them.

Members Goodlock and Blanton voiced support for stable deposit insurance premiums and viewed building the DIF reserves as prudent. Members and staff discussed the need for Committee members and others who lived through the recent crises to be the institutional memory for why higher reserves are needed when, in the future, there will likely be calls for lowering premiums. In response to a question from Member Blanton, Ms. Ellis described estimated timelines to achieve the DIF goals; she noted that the DIF was recently \$15 billion in the negative, it is estimated that it could be positive by early 2012, and that the 1.15 to 1.35 reserve ratio range might be reached by the end of 2018. She added that the cost of increasing the reserve ratios from 1.15 to 1.35 would be borne by institutions over \$10 billion in assets, not smaller ones.

Member Goodlock and Ms. Ellis discussed the comparability of the DIF reserve to a bank's loan loss reserve and how large they should be. Chairman Bair expressed the view that the DIF is better analogized to capital than a loan loss reserve, and noted that the FDIC is trying to strike the right balance in order to avoid the DIF reserve from becoming negative in the event of a future crisis.

In response to a question from Member Lewis concerning the effect of loss share agreements ("LSA") on bank failure losses and the effect of that on insurance assessments, Mr. Steckel and Ms. Ellis confirmed that LSAs were often the least cost resolution strategy, which would generally help keep assessments lower. The Committee further discussed failed bank resolutions, noting that as the FDIC and the resolution industry gained experience, the FDIC had achieved some improved resolution results. In response to a question from Member Schrieffer, the Committee, staff and the Chairman discussed the changing

characteristics of failing and problem banks since the start of the crisis.

In response to a question from Member Koch about how banks will be affected by the proposed changes in the assessment base, Mr. Steckel indicated that generally, most banks would benefit from the proposed changes, and that a small number of banks, mostly larger ones, with more non-deposit funding, would pay more. Responding to Member Rainey, Mr. Steckel estimated that assessments based on the June 2011 call report would be based on the proposed system.

In response to a question from Member Lewis, Mr. Nash stated that the FDIC continued to be strongly committed to the community banking system, which was critical to the rebuilding economy and that there was no effort afoot to squeeze them out. Chairman Bair endorsed this view and added that, although there was consolidation during the crisis, the Dodd-Frank Act favored smaller banks, noting, for example, that many new requirements explicitly did not apply to institutions under \$10 billion. In other ways, she said, the new law's changes would level the playing field that had previously favored larger institutions. The Committee proceeded to discuss the interaction of various forces acting on community banking such as the age of bank management and directors; whether the field was attractive to new entrants; and the impact of increased regulatory burden.

At Chairman Bair's invitation, several members spoke about the impact of regulatory burden, noting that, among other things, smaller banks have less capacity to digest large numbers of changes; may have inadequate earnings to afford the necessary compliance expertise; and now find too many staff focused on compliance rather than traditional banking activities. Chairman Bair suggested that, if the banking industry became engaged, the new Consumer Financial Protection Bureau ("CFPB") could help simplify rules for the mutual benefit of consumers and the industry. Member Stewart later observed that community bankers could "use this opportunity to make good reform that makes sense and does the work."

Vice Chairman Gruenberg encouraged members to provide the FDIC with a list of compliance burdens and their costs, both in existing law and in the Dodd-Frank Act. In response, Member Brown reported that the cost of responding to new overdraft opt-in rules caused a \$1 billion asset bank about \$150,000 in compliance costs, while his own \$136 million bank had increased Federal Reserve Regulation Z compliance costs of about 20

percent. Member Cole spoke about a "driftdown" effect that regulatory requirements for larger banks subsequently became good banking practices for smaller banks. Member Gray suggested that including safe harbor provisions in new laws and regulations would be extraordinarily helpful. Member Urrabazo recommended that banks be creative in responding to compliance requirements; for example, in implementing opt-in requirements, his bank had taken the opportunity to contact all of its customers and cross-sold other products. Mr. Nash urged the industry to accept the reality of the new CFPB and become constructively engaged in the regulatory process for the benefit of all. Member Miller observed that there was an important difference between regulation and enforcement of the regulation. Vice Chairman Gruenberg agreed, noting that the enforcement of regulations against non-bank financial service providers was a crucial issue and noted that it should be among the top priorities of the CFPB.

Mr. Nash then introduced Kathleen G. Nagle, Associate Director, Consumer Protection Branch, Consumer Protection and Community Affairs, DSC, and Joseph A. DiNuzzo, Counsel, Assessments and Legislation Unit, Assessments and Legislation Section, Corporate, Consumer, Insurance, and Legislation Branch, FDIC Legal Division, who led the fourth panel discussion, titled, "Deposit Insurance Coverage and Advertising Rules." Mr. DiNuzzo began by reviewing deposit insurance coverage issues with the Committee in light of the Dodd-Frank Act which raised the Standard Maximum Deposit Insurance Amount to \$250,000. After providing illustrative examples, he observed that it was possible for consumers to structure their deposits in a way to obtain a significant amount of deposit insurance coverage. Mr. DiNuzzo noted that different rules applied to business deposit accounts which are generally limited to the \$250,000 coverage limit. He noted, however, that on a temporary basis (until the end of 2012), the Dodd-Frank Act provided for unlimited deposit insurance coverage for business non-interest earning transaction accounts (a program that is separate from the Transaction Account Guarantee ("TAG") Program that will expire at the end of 2010).

Ms. Nagle began her discussion by noting that the FDIC had changed its advertising rule consistent with the \$250,000 coverage limit and that banks would need to update their teller signs by January 3, 2011. She then reviewed four products that the FDIC offers, at no cost, to assist banks and consumers to understand deposit insurance. The first is an electronic deposit insurance calculator, which can be adapted to reflect a

bank's name, logo and website appearance, if the offering bank chooses. The FDIC also provides: a call center seven days per week that responds to deposit insurance questions; the brochure "Insuring Your Deposits," which the FDIC has provided for consumer education since 1934; and telephone seminars on deposit insurance for bank employees.

The Committee then discussed, and asked questions about, various deposit insurance issues. Member Brown discussed questions that had been raised in examinations about liability concentration risk when it appeared to examiners that too many customers had deposits over the coverage limits and thus might withdraw deposits if the bank appeared to be troubled. He noted that his bank had responded by working with customers to ensure that their deposits were titled so as to be insured, so that customers would be less susceptible to fears of uninsured deposits.

Chairman Bair observed that in some failed banks, there had been complaints from uninsured depositors that they had been unaware of their lack of coverage, and solicited the Committee's views on whether it would be useful (or excessively burdensome) for banks to flag the insurance limit issue to new customers whose deposits neared the coverage limit. Members Brown and Blanton responded that such a rule may provide limited protection because many accounts are opened well below the coverage limit but drift upward over time. In response to questions from Members Brown and Rainey about disclosure requirements on sweep accounts for businesses, Mr. DiNuzzo responded that disclosure was required and model language was provided in the recent rulemaking, and would be further publicized when the rule became final. In response to a question from Member Cole, Chairman Bair stated that the FDIC and other regulators were reviewing adjustments to the dependency calculation in light of the higher insurance coverage limits. Generally, the Committee reviewed the FDIC's deposit insurance and educational products favorably. Member Blanton reported customers were much less concerned that all their deposits were covered by insurance than they had been a year ago and that he viewed it as a great sign that the crisis was passing.

The Committee held a lunch recess beginning at 12:11 p.m.

* * * * *

The meeting reconvened at 1:41 p.m. Arthur J. Murton, Director, DIR, then led the discussion of "Mitigating Systemic Risk and the FDIC's New Resolution Authority." He observed that, in the period of late 2008 to early 2009, it became apparent that government policy makers had inadequate tools to deal with the problem of institutions being perceived as "too big to fail." As a result, the Dodd-Frank Act had made important changes to the law, he said, including changes to the FDIC's role in maintaining financial stability. Mr. Murton described three broad changes in the FDIC's role and its new Office of Complex Financial Institutions ("OCFI"), of which he is Acting Director. The first change is to give the FDIC "orderly liquidation authority" to wind down systemically important bank holding companies and nonbank financial companies. This authority, he explained, allows the FDIC, in appropriate circumstances, to take control of a failing institution, and maintain the essential operations while selling off the franchise. As in a failing bank resolution, shareholders would be wiped out and creditors would be left in receivership, thus imposing market discipline on these entities. He noted that a critical difference between the FDIC process and bankruptcy is that the FDIC is able to plan ahead for such a resolution, resulting in much less disruption.

A second major change, Mr. Murton stated, is that the Dodd-Frank Act requires systemically important financial institutions to have resolution plans, also called "living wills," in which the firm provides the FDIC with information about their structure and exposures and describes a method by which they could be resolved (though the FDIC would not be bound by the plan if resolution actually became necessary). He noted that the resolution plans would be made pursuant to regulations issued jointly by the Federal Reserve and the FDIC, and reviewed by them. If the plans are deficient, the agencies can require changes to be made to them, or, ultimately, require divestiture of certain operations. Mr. Murton added that the resolution plans would not be one-time paper exercises, but rather, would be reviewed and updated on a regular basis.

A third change that Mr. Murton discussed was the Dodd-Frank Act's creation of the Financial Stability Oversight Council ("FSOC") that would take a broader look at financial trends and risk that had not been accounted for in the previous regulatory structure, and to address those issues as they arise. The FSOC has issued two Advance Notices of Proposed Rulemakings, he noted: one addressing how systemically important firms should be designated; and how to implement the Volcker Rule to end

proprietary trading. In order to support the FDIC Chairman's role on the FSOC, Mr. Murton described several steps the OCFI will take to maintain a thorough understanding of how these financial institutions operate. One step will be to increase monitoring of such firms, including increasing the number of FDIC personnel in the largest banks. Another step will be to engage in horizontal, or peer, analysis of the institutions to identify where systemic risk is building. Other parts of the OCFI, he noted, will review the resolution plans/living wills of such firms, and another group will address international and cross-border issues to facilitate possible resolutions. Mr. Murton and Chairman Bair noted that no DIF funds would be used to support OCFI activities that do not relate to insured institutions.

The Committee then discussed various issues relating to the new Dodd-Frank Act responsibilities, including: possible dilution of the FDIC "brand" as the FDIC addresses issues other than insured deposits; how monitoring of non-bank financial institutions will differ from that of insured institutions; and the budget for the OCFI (approximately \$20-30 million per year). Vice Chairman Gruenberg noted that a new tool the FDIC will have is the back-up examination authority for certain bank holding companies, in addition to the banks within them. Finally, Member Brown remarked that public relations will be important to the success of the new responsibilities, and noted that, in his experience, discussions of the "living will" concept resonated particularly well with the public. Member Cole expressed her appreciation for the FDIC's commitment to ending the perception that some institutions were too big to fail.

Mr. Nash then introduced Ellen W. Lazar, Senior Advisor to the FDIC Chairman for Consumer Policy, and Luke H. Brown, Associate Director, Compliance Policy Branch, DSC, who discussed "Consumer Protection and Compliance Issues" with the Committee. Mr. Brown noted that the FDIC's new Division of Depositor and Consumer Protection, which will be separate from the risk management division, would become operational in early 2011, under the leadership of Mark Pearce, until recently Chief Deputy Commissioner of Banks for North Carolina. He discussed the Dodd-Frank Act's division of consumer protection responsibilities between the new CFPB and the FDIC; noting that the CFPB would have most of the rule writing authority and examination and enforcement duties for institutions with assets over \$10 billion, while the FDIC would retain its examination and enforcement authority for insured institutions up to \$10 billion. With regard to those latter 4,700 institutions, Mr.

Brown anticipated no significant changes in the FDIC's examinations or other interactions with those institutions.

Mr. Brown discussed recent proposed guidance on overdrafts that was based on the results of a national survey and which updated 2005 interagency guidance. He described the guidance as targeted to automated overdraft programs that are overused by some consumers, and reminds institutions to make meaningful disclosures and to ensure that consumers understand the risks and costs associated with overdraft protection. He indicated that staff is currently reviewing public comment on the proposal.

Mr. Brown also discussed a variety of recent and current Community Reinvestment Act ("CRA") activities, including: a series of interagency hearings across the country about whether the CRA regulations should be revised; recent changes to the CRA regulations to support the stabilization of communities affected by high foreclosure rates; revisions to CRA regulations concerning student loans; and a recent CRA forum for FDIC examiners.

Ms. Lazar then provided the Committee with information about two FDIC pilot programs, one for transaction accounts and one for savings accounts, aimed at increasing the availability of banking services for moderate and low income consumers. She explained that the guiding principles for the accounts included: having transparent rates and fees that are reasonable and proportional to costs; being FDIC insured and compliant with consumer protection laws; and being electronic, thus helping to limit banks' acquisition and maintenance costs. The FDIC would soon review applications from banks to participate in the pilot programs, which would run for one year, and which will yield information about the viability of the accounts, as well as their volume, use, and profitability. Ms. Lazar also discussed a recently concluded pilot program aimed at providing small dollar loans to consumers, as alternatives to overdrafts and payday lending. In response to questions from Committee members, she confirmed that the pilot programs were meant to encourage banks to engage in the activities by providing information, and were not mandatory. Chairman Bair added that the pilots were an outgrowth from the FDIC Advisory Committee on Economic Inclusion, were related to a study of the unbanked led by Vice Chairman Gruenberg, and were an attempt to bring more unbanked and under-banked consumers into the banking system by providing accounts that worked for their basic financial needs.

The Committee then discussed a variety of consumer banking and protection issues, including: the interaction of the small dollar loan program with state usury laws (Member Urrabazo); and banks' reluctance to provide check cashing for checks not drawn on their own accounts (Member Blanton). In response to Member Cole's inquiry whether the small dollar loan pilot program had been profitable or cost neutral, Chairman Bair responded that they had been profitable overall. Ms. Lazar provided further data about the pilot program's charge-off and delinquency rates.

Member Rainey described a problem facing banks concerning the authorization of ACH transactions that are then not submitted for payment until after the account balance has been reduced by subsequent check transactions to a point below the authorized ACH amount. In such cases, she noted, regulations require that the bank must pay the authorized ACH amount but do not allow it to charge the customer. Member Rainey reported that such occurrences cost her bank about \$50,000 per year; Member Goodlock reported that his bank had \$30,000 of such costs per year.

Member Rainey also described a CRA problem that her bank had experienced because a recent surge of deposits had caused the bank's loan to deposit ratio to go to historical lows. She indicated that single factor had adversely affected the bank's CRA rating. Member Urrabazo observed that the loan side of the CRA equation is very heavily weighted, and Member Blanton suggested that a bank's market environment needs to be factored into CRA ratings. Chairman Bair inquired whether regulators fail to look sufficiently at the saving side of the CRA equation. Mr. Brown of DSC agreed that examiners should be looking at the bank's performance context and making appropriate adjustments.

The Committee engaged in a wide-ranging discussion of overdraft program issues, including customers' frequency of use, the costs of frequent usage, the reasons for it, and alternatives to it. It was noted that the bulk of overdraft program fees tended to be paid by lower income customers. Member Urrabazo contrasted banks' traditional response to overdrawn checks (honoring approximately 15 percent and returning about 85 percent), to the reverse treatment in overdraft programs (accepting about 80 percent of overdrafts). He noted that the current treatment was possible because of volume considerations, and that the overdraft program fees made it possible to offer other bank products for free. He and Chairman Bair discussed the relationship of frequent overdraft

program use to the extension of credit to such customers. Chairman Bair inquired why banks did not set up lines of credit for highly frequent users, or view overuse as a financial education issue and ensure that such customers were fully informed about credit alternatives that they might have, especially in light of the relatively high cost of overdraft program fees. In addition, she inquired whether regulators had contributed to the prevalence of overdraft programs instead of credit because the regulatory burden was higher on extending credit than charging fees.

The Committee members provided feedback on a variety of overdraft program issues. Members Blanton and Urrabazo reported that 81 and 85 percent of their customers, respectively, had chosen to opt in to their programs, and that frequent users were among the first to do so. Member Stewart advised that one should be cautious in viewing overdraft program fees as very expensive credit because, for customers in a difficult economic environment, such fees might be the best bargain in town compared to incurring late fees or charges elsewhere. Regarding the option of opening lines of credit for frequent overdraft program users, Member Schriefer noted that, in his experience, the line of credit was quickly used and not repaid, so that the customer was not put in an improved situation.

Member Blanton, responding to the idea of contacting frequent overdraft users, expressed concern that such contacts might encourage customers to leave the banking relationship, especially if such calls began at six uses per year, which he viewed as too early. Vice Chairman Gruenberg shared observations about overdraft usage rates based on the FDIC's national survey, and supported the idea of ensuring that frequent users were aware of alternatives. Chairman Bair indicated that complaints about overdraft programs had doubled in the last couple years and that she viewed them as a reputational risk issue for community banks. She asked the Committee and community bankers to continue to think constructively with the FDIC about how to resolve the issue so that overdraft programs did not need to be an early focus of the new CFPB or discourage people from entering and maintaining banking relationships.

The Committee stood in recess at 2:49 p.m.

* * * * *

The meeting reconvened at 3:00 p.m. that same day. Mr. Nash then introduced Roberta K. McInerney, Deputy General Counsel, Corporate, Consumer, Insurance, and Legislation Branch, FDIC Legal Division, for the "Roundtable Discussion on the Dodd-Frank Wall Street Reform and Consumer Protection Act and Other Issues." Ms. McInerney noted that the FDIC was tasked with 44 rulemaking initiatives under the Dodd-Frank Act and reviewed with the Committee how they and the public can access information about them through the FDIC website. She described how the website provides links to information on a great variety of topics, including: the legislation itself; links to webcasts of roundtable discussions of important issues; proposed rulemakings on which the public can comment; documents that describe steps the FDIC has already taken; as well as objectives and timetables for taking action on remaining legislative mandates. Mr. Nash indicated that the FDIC and other agencies were engaged in a substantial amount of consultation on many topics, and that it was not true that work is happening in silos; he then solicited questions and observations from the Committee.

Member Lewis flagged a developing issue regarding correspondent banks and large banks not supporting letters of credit for community banks because of concerns about the treatment of them if the community bank failed. Mr. Spoth indicated that he would follow up on the issue on behalf of the FDIC.

At the request of Mr. Nash, the Committee members discussed economic and banking conditions in their regions. Member Blanton noted that, in Georgia, some areas continued to struggle while others were doing better, with good employment and good industry; although the economy was slow, it was acceptable. Although not many banks were raising capital, he observed that some organizations were acquiring banks through FDIC loss share agreements and other means. Member Stewart noted that most distressed banks in the Washington region were west of the Cascade Mountains and that some of the problem banks had been able to recapitalize. Unemployment was down a small amount, she said, home values had stabilized in the Puget Sound region, and her bank was experiencing an unanticipated refinancing boom.

Member Koch reported that the South Carolina economy was flat at best; unemployment was at about 11 percent. He said that bankers were primarily just treading water, trying to reduce concentrations and that there was little new lending. Member Gray indicated that California had pockets that were

doing well and others that were really suffering. A major concern, in his view, was the state government budget deficit. He also reported that there was high unemployment, that prospects were relatively poor because the economy was less diversified than in the past, and that many jobs were permanently gone. He indicated that there was increasing talk of mergers among weak banks.

Member Goodlock stated that agriculture and tourism were bright spots in Michigan, but that its largest industry, automobile manufacturing, was still suffering. He reported that some pockets of the state continued to do well but that others, including the Detroit area, still suffered. There had been failed banks for which there had been no bidders for the assets, he said, and recently, there had been talk of "zombie" banks that were not failing but had trouble growing because of capital constraints. He indicated that real estate values appeared to have hit their low, and also that he was concerned what would happen if unemployment compensation was not renewed. Member Rainey stated that New Mexico was still technically in recession but that, in the northern part of the state, the economy seemed to have settled. She reported that there were some signs of returning loan demand but it was occurring in areas where the bank had to manage concentrations, such as CRE and construction. Member Brown of Florida stated that he was currently more optimistic than he had been 90 days earlier. He noted that lower end housing was stabilizing, that vacant land prices had settled quite a bit, but that CRE was unclear, and that there might be a burst of foreclosures.

Member Schriefer reviewed the economic conditions in different parts of Kansas: the Kansas City area struggled the most, with many unprofitable banks; the Wichita area was fairly flat; and agricultural areas, such as Russell, were doing better. In his view, one quarter of banks in his region were looking forward to new opportunities; half were just holding steady, and one quarter were questioning their future due to regulatory or management problems. Member Urrabazo reported that although some pockets of Texas still suffered, the metroplexes had done fairly well. The real estate market remained down overall, in his view, but there had been an influx of new jobs and residents. He observed that the import-export business in border areas had picked up, likely because of increased car manufacturing, and that many banks were adjusting to restructurings that occurred in the prior year.

Concerning Tennessee, Member Cole reported that they had experienced fewer bank closures than other areas but that many smaller community banks needed capital boosts. She reviewed economic issues in different areas of the state and noted that Nashville condominium developments had been a big problem and continued to be a challenge for banks. Member Miller indicated that the New England economy was adequate overall, that there had been less overbuilding there than in other areas, and that unemployment had begun to ease, although it remained the biggest challenge. Member Lewis described the Phoenix, Arizona area as being "in the tank" and that, with the volume of vacant CRE there, it would be a long time before they pull out. Tucson, on the other hand, was much better off and had some industries starting to see increases, such as defense, biomedical research, and agriculture.

Member Lewis also inquired about the FDIC's views about the Committee's contributions over its year of existence and if a scorecard of issues might be created. Mr. Nash responded that the Committee had provided an early warning to the FDIC about the TAG account which enabled the FDIC to take proactive steps on the issue. The FDIC had also found the Committee's contributions on overdraft protection to be very helpful as the FDIC developed its policies, he said, and intended to rely on the Committee in a similar way in the future. Finally, Mr. Nash noted generally that it was helpful for the FDIC to hear from a cross-section of the industry from around the country. Chairman Bair stated that the Committee had exceeded expectations at each meeting and continued to get better. Agreeing with Mr. Nash's observation about the TAG program, she added that she learned a lot at each meeting and created lists of subjects to pursue afterward, such as: FDIC's stress testing expectations, requiring appraisals, workouts and/or write downs, and their pro-cyclical impact; and the effect of deposit ratios on CRA ratings and how the FDIC deals with that. Chairman Bair said that she found the meetings helpful to her and hoped that the Committee also found them helpful to know what the FDIC was thinking. Vice Chairman Gruenberg agreed with the Chairman's appreciation for the Committee's input, and noted in particular that the Committee's "granular feedback" gave him and the FDIC a much better feel for the banker's perspective, which allowed the FDIC to make better informed judgments on the various issues before it.

There being no further business, the meeting was adjourned.

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

October 14, 2010

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
October 14, 2010 - 8:38 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
October 14, 2010, Meeting of the
FDIC Advisory Committee on Community Banking

Dated: January 18, 2011