

The Meeting of the Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the William Seidman Center

Federal Deposit Insurance Corporation Building

Arlington, Virginia

Open to Public Observation

November 20, 2014 – 9:00 A.M.

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

The members of the Committee present at the meeting were: Robert F. Baronner, Jr., President and Chief Executive Officer (“CEO”), Bank of Charles Town, Charles Town, West Virginia; Cynthia L. Blankenship, Vice Chairman and Chief Operating Officer, Bank of the West, Grapevine, Texas; Pedro A. Bryant, President and CEO, Metro Bank, Louisville, Kentucky; Leonel Castillo, President and CEO, American Bank of Commerce, Provo, Utah; Jane Haskin, President and CEO, First Bethany Bank & Trust, Bethany, Oklahoma; James Lundy, Chief Executive Officer, Western Alliance Bank, Phoenix, Arizona; Kim D. Saunders, former President, CEO and Director, Mechanics & Farmers Bank, Durham, North Carolina; Dorothy A. Savarese, President and CEO, Cape Cod Five Cents Savings Bank, Orleans, Massachusetts; and David Seleski, President, CEO and Director, Stonegate Bank, Fort Lauderdale, Florida;

Carolyn “Betsy” Flynn, President and CEO, Community Financial Services Bank, Benton, Kentucky, Mark Hesser, President, Pinnacle Bank, Lincoln, Nebraska, Joseph G. Pierce, President and CEO, Farmers State Bank, Lagrange, Indiana, Mark Stevenson, President and CEO, Capital Pacific Bank, Portland, Oregon, Alan Thian, President and CEO, Royal Business Bank, Los Angeles, California, and Derek Williams, President and CEO, Columbus Community Bank, Columbus, Georgia were absent from the meeting.

Members of the FDIC Board of Directors present at the meeting were: Martin J. Gruenberg, Chairman, and Jeremiah O. Norton, Director (Appointive).

Corporation staff who attended the meeting included: Willa M. Allen, Ruth R. Amberg, Eric C. Breitenstein, Richard A. Brown, Robert L. Burns, Patricia A. Colohan, Kymberly K. Copa, Charles W. Collier, Carolyn D. Curran, Christine M. Davis, Patricia B. Devoti, Doreen R.

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Eberley, Diane Ellis, Shannon N. Greco, Barbara Hagenbaugh, Leon Hartley, Debra L. Hendricks, Lauren S. Hertz, Penny B. King, Christopher Lucas, Rose McDermott, Roberta K. McInerney, Jonathan N. Miller, Rae-Ann Miller, Christopher J. Newbury, Thomas E. Nixon, Elizabeth Ortiz, Richard J. Osterman, Mark E. Pearce, Marlene M. Roberts, Claude A. Rollin, Barbara A. Ryan, Donald R. Saxinger, Robert F. Storch, Ann Johnson Taylor, Ross Waldrop, James C. Watkins, and James Yagley.

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

Chairman Gruenberg welcomed the Committee and provided an overview of the day’s agenda. He noted that there would be discussions of: the FDIC’s community bank initiatives, including technical assistance videos; a discussion of recent FDIC research on branch banking; an FDIC review of regulations for burden reduction and ways in which the Call Report could be streamlined; initiatives relating to cybersecurity; and new supervisory guidance and rulemakings. Chairman Gruenberg also expressed appreciation to six members for whom this would be their last Committee meeting: Robert Baronner, Dorothy Savarese, Kim Saunders, Joseph Pierce, Elizabeth Flynn and Alan Thian. He introduced Chief of Staff Barbara Ryan, who moderated the day’s proceedings.

Ms. Ryan introduced the first panel, “Update on Community Bank Initiatives” and the speakers: Doreen Eberley, Director, Division of Risk Management Supervision (“RMS”); Mark Pearce, Director, Division of Depositor and Consumer Protection (“DCP”); Diane Ellis, Director, Division of Insurance and Research (“DIR”); and Richard Brown, Chief Economist. Ms. Eberley began by discussing the FDIC technical assistance video program which has had about 130,000 views in its 18 months of existence. She said that the most popular videos in the Directors’ College were interest rate risk and Bank Secrecy Act, while the most popular technical assistance videos were interest rate risk and flood insurance. Ms. Eberley said that a video on lender management would be released in early 2015. She also described a two-part survey the FDIC developed to get feedback about the video technical assistance program. The first part would ask a bank representative to indicate: if the bank was aware of the video program; how it learned about it; whether any staff had watched videos; whether the topics were useful; and what topics would be helpful to the institution. Ms. Eberley said that the second part of the survey would be directed to anyone who watched a video and ask them specific questions about what they had seen, including whether the video was helpful and, if the video was not helpful, why that was so. She said that the FDIC intended to send the survey to about 200 institutions in each of three asset size categories.

Mr. Pearce discussed various FDIC initiatives to assist community banks to understand and comply with changes to the mortgage rules. First and primarily, he said, the FDIC provides teleconferences to familiarize bankers with the new rules and help them adjust their systems to them; he said that a recent teleconference on frequently asked questions had over 1,000 banks call in. Mr. Pearce also discussed three recent technical assistance videos targeted to the use of bank compliance officers: the ability to repay rule/qualified mortgages; the mortgage servicing rule; and the mortgage loan originator compensation rule. He said that the videos try to help community bankers on two levels: first by providing insights into the substance of each rule;

and, second by concentrating on the parts of the rules most likely to affect community banks. Mr. Pearce provided examples of the community bank focus from each of the three videos and then played a brief sample of the ability to repay/qualified mortgage video for the Committee. He added that two more videos were in production and would likely be released by early 2015.

Member Castillo asked if DCP's examinations had identified any impacts of the new mortgage rules. Mr. Pearce said that the FDIC monitored the issue closely and that examiners were talking with institutions about how they were adjusting their systems to comply, but noted that it was too early to tell what the cumulative impacts of the rule would be. He said that early anecdotal reports indicated that banks were not making significant shifts in their product offerings or their engagement in the mortgage market as a result of the rules. Member Bryant said that the small entity compliance guide would be helpful to the many small banks in Kentucky.

Ms. Ellis discussed community banking research the FDIC published in 2014, including: trends in bank consolidation; trends in banking and population in rural areas; performance and condition of minority depository institutions; and, most recently, branch banking. She said that the DIR intended to continue a robust research program and welcomed suggestions about useful subjects to pursue. Mr. Brown then discussed recent research about branch banking in the U.S., referring to a handout titled "Branch Banking in the U.S.: Long-Term Trends and Recent Developments." He noted that there were about 95,000 retail banking offices in the U.S. in June 2014; about 7 percent are headquarters offices and the rest are branch offices. Mr. Brown said that he would discuss four structural trends that the research identified and factors that have contributed to those trends. He observed that technology is an important underlying factor; technology has created alternatives to doing transactions in person, thus raising the question whether technology is a substitute or a complement to physical banking offices.

The first trend Mr. Brown discussed was the long term growth in the number of banking offices. He observed that since 1970, there was a more than 100 percent increase in the number of banking offices, while there was a 56 percent increase in the population. Mr. Brown noted that the increase in offices occurred in the same period as technological innovations, such as ATMs, were introduced and became common. The second trend Mr. Brown discussed was the cyclical nature in the number of offices in the last 30 years. He noted the cycles were related to banking crises rather than business cycles. Mr. Brown said the health of the banking industry was a factor that governed the number of offices, as well as liquidity and loan demand.

The third trend Mr. Brown discussed was the geographic differences in the growth in the number of offices. Referring to a map showing 37 states with increases in the number of banking offices and 13 with decreases, he made observations about the causes of the declines in New England and the upper Midwest. Mr. Brown said the relaxation of geographic restrictions on banking in the 1980s and early 1990s was an important factor affecting the number of offices. In places where there had been laws imposing geographic restrictions on banking, there was often above average growth in the number of offices after the restrictions were lifted. A fourth trend Mr. Brown said was that consolidation has moved banking offices into larger institutional networks. In this regard, he noted that before 1994, very few banking offices operated within very large (1,000 office or more) networks, but that had changed so that almost one-third of total

banking offices are part of just 11 institutions with networks of 1,000 offices or more. Mr. Brown indicated that large banks, in particular, increased the size of their office networks following the relaxation of geographic restrictions after 1994.

Mr. Brown then discussed the density of banking offices. He said that the peak occurred in 1987-1989 with 3.4 offices per 10,000 persons, but noted that the current 2.9 offices per 10,000 people was higher than at any time prior to 1977. Mr. Brown discussed the question of how many banking offices are required to reach a certain number of customers. He noted that the average number of teller transactions per branch declined by 45 percent since 1992 and that more than 50 percent of adults banked online as of 2013, but noted that, at the same time, tellers remain the most common way households interacted with their institution. Mr. Brown also observed that demographic factors influenced branch usage; younger persons tended to use branches less often than older persons. However, he observed that office density had increased about one-third in the same period since ATMs were introduced, thus indicating that physical banking offices remain important.

Mr. Brown made additional observations about banking office density over time. He noted that density increased since 1987 in states that were previously unit banking states, but declined at twice the national average in states that already had statewide branching in 1979. He also observed that the research indicated that office density tended to be stable within geographic regions; places that had high (or low) office density in 1987 tended to remain that way. Mr. Brown noted that rural counties tended to have the highest density of offices, while metropolitan areas have the least density, with micropolitan areas being in between. He observed, however, that 50 percent of rural counties lost population since 1980 and noted that this movement of people to more densely populated places is a factor governing overall banking office density.

Mr. Brown indicated that the number of community bank offices remained relatively stable since the mid-1990s, while non-community banks added offices. He noted that, since the 1994 low point for the total number of banking offices, the number of community bank offices declined about 6.5 percent, while the number of community bank charters declined by 44 percent. In the same period, he said, non-community banks amassed much larger numbers of offices, increasing them by 36 percent while the number of their charters decreased by 71 percent. Mr. Brown indicated that non-community banks have assembled offices, often through mergers, and moved into fast growing areas. He said there are over 1,200 U.S. counties (more than one-third of all counties) in which community banks hold 75 percent or more of the total deposits; the population of those counties is about seven percent of the U.S. population. By comparison, counties where non-community banks hold 75 percent or more of the deposits have 62 percent of the U.S. population.

Mr. Brown observed that FDIC insured institutions had opened and closed thousands of banking offices since 2008; between 2008 and 2014, more than 10,000 were opened and more than 13,000 closed. He said an important result was that there was a net transfer of offices from community banks to non-community banks; specifically, in that period, community bank offices declined by almost 9 percent while the non-community bank offices declined by almost 2 percent. Mr. Brown noted, however, that community banks had opened more offices than they had closed in the 2008-2014 period; the net change in number of community bank offices, he

explained, was due to large community banks being acquired or growing out of community bank status. Mr. Brown said that community banks are a relative source of stability in terms of the number of banking offices and that branch banking is still very important to the community banking business model.

Member Savarese thanked the FDIC for its research and discussed the interaction of technological change, the number of branches, and how customers use them. She said that remote deposit capture using mobile methodologies, for example, is a transformative technology. Member Savarese recommended that the FDIC continue to probe whether the changes it identifies are cyclical or secular; she indicated that she was skeptical that the changes were merely cyclical, her hypothesis was that more secular change was occurring. Mr. Brown agreed that those are important questions. He observed that the evidence to the present time indicated that technology had not yet replaced customers' preference for providers who have physical offices staffed with people who can provide reassurance when there are technological problems. Mr. Pearce said that recent survey data supported the view that technology and physical bank branches had a complementary relationship. Specifically, he said, survey data indicated that, even among people whose primary strategy for dealing with a financial institution is online or mobile, 70 percent of those people also visited a bank branch in the last 12 months. Member Savarese cautioned against making assumptions that people will always prefer the security of face-to-face interaction or dealing with FDIC insured institutions. She noted that her interactions with persons in their 20's indicated that they did not place high value on the security of their financial transactions. Member Blankenship agreed that the millennial generation did not greatly value security or physical banking offices. She suggested that more research into millennials' views would be helpful because they would have a big impact on how the financial system is accessed and on branch structure.

Member Castillo asked if the FDIC had additional information about the actual transactional activity at branches and if it was changing significantly. He observed that some financial institutions, such as Ally, had a non-brick-and-mortar strategy. Member Castillo also inquired about the impact of credit unions on the number of branches. Mr. Brown said that there had been tremendous growth in the credit union industry over a long period and that it was something that the FDIC would continue to monitor. Regarding teller transactions, he said that some external studies indicated that the number of teller transactions had declined by about 45 percent since 1992. Mr. Brown said that there is somewhat of a conundrum at the present, there are still many physical locations, but many transactions are occurring through other venues; he noted that about 92 percent of business checks had been electronically imaged in the last year, thus showing a huge amount of electronic delivery of some financial services. Member Saunders said that her institution had established a student advisory board of high school and college students and found that their banking perspectives were significantly different than older persons'. However, she said that the students indicated that branches were still important to them for the personal, familiar experience that they provided and because the students wanted a person to talk with if they experienced a problem. Member Saunders indicated that her view was that there would continue to be a need for brick-and-mortar locations.

Member Blankenship inquired if the FDIC's data indicated why branches remained relevant to the people who used them. Because of the evidence of the number of transactions

decreasing, she suggested that some branches may be just loan offices; she observed that loan customers would continue to need and want to come to a physical location. Mr. Brown said that the FDIC's information is primarily focused on the deposit side, the FDIC can look at how big offices are and how many deposits they control; the FDIC does not have similar information about the lending side. In response to a question from Member Lundy about limited branching in grocery stores, Mr. Brown said that there had been growth in those in the 1990's followed by a plateau in the numbers.

Member Lundy referred to the map of U.S. counties showing where community or non-community banks controlled 75 percent or more of the deposits and suggested that the FDIC share it with the Consumer Financial Protection Bureau ("CFPB") as it deals with defining rural areas for the purpose of the Qualified Mortgage ("QM") rule. He indicated that the map helped illustrate that a rural area can be relatively close to a metropolitan area. Mr. Pearce noted that the CFPB had indicated that it was continuing to review the definition of rural and that the FDIC would continue to share its perspective on where community banks are and the rural aspect of some of them. Referring to the same map, Member Haskin asked about the deposits per branch in the larger banks compared to community banks as an indicator of branch viability. She indicated that this information might indicate how viable a branch was going forward; a branch that has lots of deposits and loan activity would be more viable than one that did not.

Member Castillo inquired if the FDIC had seen any indication of banks using their branches differently as the number of transactions went down. He noted that his bank's deposits had doubled, but its staff had decreased approximately 30 percent; he said that his bank was exploring different uses for its building to take advantage of its asset in a new way. Mr. Brown agreed that community banks are looking for ways to generate non-interest income, but that the FDIC did not have much data available on the subject. Member Baronner observed that banks may need fewer employees to do tasks such as cashing checks, but that they might keep their branches and have employees with higher skill levels who can respond to developing customer needs.

Chairman Gruenberg complimented the research and said that, like any good research, it raised many questions. He said that, before becoming aware of the research results, his expectation would have been that technology and online avenues would have had a more dramatic impact on the number of banking offices and a significant reduction in branch bank utilization. Instead, the Chairman observed, the large majority of people with a banking relationship in the U.S. still utilize bank branches in addition to online access, and the number of banking offices has remained relatively stable. He added that qualitative questions remain, such as the intensity of branch usage by bank customers, what branches are being used for, and the interaction between online and physical access to the system.

In response to Chairman Gruenberg's invitation, several members provided additional comments on the panel's subject. Member Savarese agreed with Chairman Gruenberg's observations and also noted that a difficulty facing community banks is that brick-and-mortar decisions play out over extended time periods. She also noted that what is typically thought of as a "banking" transaction might be actually migrating to other systems not controlled by banks, such as PayPal. Member Lundy discussed a situation where his bank, which had previously

stopped mortgage lending, chose to make a first mortgage as part of a commercial loan. He indicated that the CFPB had specifically chosen to include the bank's situation in its rule's coverage and that compliance with the rule was burdensome because it had to be done for a rare situation rather than part of its ongoing business model. Member Lundy said that the situation appeared to be an example of unintended consequences. Mr. Pearce said, as the QM rule had gone into effect, DCP was receiving more questions from bankers about the application of the rule to unusual situations. He indicated that examiners needed to be conscious of these unusual situations so that they could provide the correct guidance. Member Blankenship said that the technical assistance videos on the mortgage rules were very effective and that she intended to make sure that all her branch staff reviewed them. Mr. Pearce said that the FDIC appreciated the feedback on what bankers found useful. Member Lundy suggested that an effective way to let banks know about the videos would be to routinely discuss them at the opening meeting of examinations. He observed that a bank's executive management attend those meetings, as do many directors, and that the information communicated in the meeting is taken very seriously.

For the second panel, "Update on FDIC's Regulatory Review under the Economic Growth and Paperwork Reduction Act ("EGRPRA"), Ms. Ryan introduced Roberta McInerney, Deputy General Counsel, Ruth Amberg, Assistant General Counsel, and James Watkins, Senior Deputy Director, RMS. Ms. McInerney provided an overview of the EGRPRA review process which requires the FDIC, OCC and the Federal Reserve Board to conduct a review of their regulations every ten years to identify any that are outdated or unnecessary; she noted that the first EGRPRA review was completed in 2006 so that the second one would be completed in 2016. She observed that EGRPRA requires the agencies to categorize their regulations by type, and then publish one or more categories for comment at regular intervals requesting the public to identify those that are outdated, unnecessary or unduly burdensome. Ms. McInerney said that the agencies coordinated their effort and would publish 12 categories of regulations in four separate *Federal Register* notices. The first notice (concerning the categories of: applications and reporting; powers and activities; and, international operations) was published in June 2014 and closed for comment on September 2, she said, and 40 comment letters were received.

Ms. McInerney said the banking agencies were seeking direct banker input through at least five outreach sessions that would be held around the country over the next 12 months. At the meetings, there would be panels of banking groups moderated by an agency representative and audience members would have the opportunity to ask questions and make comments. The first meeting would be in Los Angeles on December 12, she said, and would be attended by Chairman Gruenberg and Comptroller Curry. Ms. McInerney said that spaces were still available for the Los Angeles meeting which would also be livestreamed so that non-attendees could listen to the discussion. Later meetings would be held in Dallas, Boston, Chicago and Washington, D.C., she noted.

Ms. McInerney said that, at the conclusion of the comment periods for all the categories of regulations, the agencies' staffs would summarize the comments, including those from the outreach sessions, and publish the summary together with the agencies' response to significant issues raised. The agencies would then report to Congress about the significant issues raised, their relative merits and whether the agencies can make responsive changes to regulations or whether additional legislation would be required.

Mr. Watkins then spoke about two financial institution letters (“FIL”) that the FDIC issued; the first FIL is titled “Guidance Related to the FDIC Statement of Policy on Applications for Deposit Insurance” (FIL 56-2014). Mr. Watkins said that the FDIC’s primary sources of guidance on deposit insurance applications are contained in the FDIC’s rules and regulations and the Statement of Policy on Applications for Deposit Insurance. The new FIL was developed to further aid applicants in developing proposals for new banks, he said, and was prompted, in part, because of comments received in the EGRPRA review process. The FIL addresses four issues in the form of Questions and Answers. The first topic is pre-filing meetings. Mr. Watkins said the FIL reinforces the point that pre-filing meetings coordinated with the FDIC Regional Office are strongly encouraged and should be attended by individuals with the greatest knowledge of the significant aspects of a proposal. The FIL’s second topic is FDIC processing timeline, he noted, which is usually done four to six months after an application is considered substantially complete. The third topic is initial capitalization, which needs to be sufficient to provide a Tier 1 leverage ratio of at least eight percent through the first three years of operation, he said. The fourth topic addressed in the FIL is the initial business plan, which should also cover the first three years of operation.

The second FIL Mr. Watkins described is titled “Filing and Documentation Procedures for State Banks Engaging, Directly or Indirectly, in Activities or Investments that are Permissible for National Banks” (“FIL 54-2014”). As background, he noted that bank activities are governed by Section 24 of the Federal Deposit Insurance Act and Part 362 of the FDIC’s regulations. Mr. Watkins said that, until the announced change, State banks seeking to conduct activities through limited liability companies (“LLC”) were required to file an application with the FDIC. He noted that the FDIC processed over 2,200 applications over the last decade and the vast majority of them related to LLC or similar structures. Mr. Watkins said that the FDIC had recently evaluated the application requirements and determined that applications would no longer be required for State banks to engage in otherwise permissible activities through LLCs. In essence, he said, State banks would be able to establish an LLC without filing an application with the FDIC provided that the activity is permissible and the bank maintains documentation concerning the activity’s compliance with Part 362. Mr. Watkins said that the new policy would reduce burden by requiring far fewer applications and would allow cases that still required applications to usually be resolved at the Regional Office level.

In response to a question from Member Castillo, Ms. McInerney and Ms. Amberg said that the 2006 EGRPRA report to Congress recommended changes that resulted in burden reduction legislation that was passed. Ms. McInerney and Ms. Amberg said the agencies also reviewed what streamlining and simplifying they could do at the regulatory level and took burden reduction steps concerning deposit insurance rules, as well as procedural, examination and information technology processes. Member Castillo indicated approval of the burden reduction effort and suggested that the agencies publicize the beneficial effects of the review completed in 2006.

Member Blankenship inquired about the types of activities for which banks most often used LLCs. Mr. Watkins said the most typical use of LLCs was in the commercial real estate foreclosure process; the LLC could help shield the institution from potential liabilities while still

allowing the foreclosure process to proceed. He added that the use of an LLC is not limited to that purpose, however, and that a bank may use the LLC for any permissible activity as long as it documents how the practice complies with Part 362. In response to a question from Member Castillo, Mr. Watkins said that the FILs had been prompted in part by EGRPRA comment letters and feedback received in banker roundtables; on the LLC matter, he said that the FDIC reviewed its policy and decided that it could make the change. Ms. McInerney added that, under the EGRPRA process, if the agencies can fix an issue immediately they will try to do so. In response to a question from Member Savarese, Ms. McInerney clarified that many consumer rules are now the responsibility of the CFPB and not technically subject to the EGRPRA review process; however, the EGRPRA agencies welcomed comment on those subjects because they are important to bankers and the FDIC is in regular contact with the CFPB concerning its regulations.

Ms. Ryan then introduced the speakers for the panel titled “Bank Regulatory Reporting,” Robert Storch, Chief Accountant, RMS, Charles Collier, Chief, Risk Analysis Section, RMS, and Ross Waldrop, Senior Banking Analyst, DIR. Mr. Storch noted that the Independent Community Bankers of America (“ICBA”) had proposed that, for well-capitalized and highly rated community institutions, the banking agencies institute a short-form Call Report for the first and third quarters of each year (while maintaining a full Call Report for the second and fourth quarters). In response to the ICBA proposal, he said the Federal Financial Institution Examination Council (“FFIEC”) Task Force on Reports (“Task Force”) had taken various steps and will be advising the FFIEC on a range of possible actions that the FFIEC agencies could take.

Mr. Collier and Mr. Waldrop discussed some uses that the FDIC makes of Call Report data to provide context for Mr. Storch’s later discussion of possible changes to the Call Report. Mr. Collier said that Call Report data are used in ratio analysis through the Uniform Bank Performance Report (“UBPR”). He said the UBPR has about 1,500 ratios that are made publicly available and are heavily used by regulators, bankers, and the public. Mr. Collier said the FDIC uses Call Report data to assess risks in banks and to plan onsite examination activities. He said the interest rate risk tool was dependent on quarterly Call Report data and would be severely impacted by the ICBA proposal. Mr. Collier noted that the information requested in RMS’s pre-examination entry letters would also need to be increased if less information was available through quarterly Call Reports. He added that the Federal Reserve had recently moved from a 12 month to an 18 month examination cycle because Call Report data was currently available for examiners, but that reduced amounts of information from the Call Report might result in an increase in examination activity or accelerated activity.

Mr. Waldrop discussed how Call Report data is used by the FDIC’s research components, including the *Quarterly Banking Profile* (“QBP”). He observed that the QBP was developed because it was believed that publishing timely, comprehensive and authoritative data about financial institutions was an antidote to public uncertainty and misconceptions during a banking crisis. Mr. Waldrop said that the QBP regularly draws from about 18 of 24 schedules of the FFIEC 041 Call Report so the information banks provide is extensively used.

Mr. Waldrop described how, since the development of the internet, the FDIC was able to provide data directly through its website. In addition, he said, the FDIC is now able to provide data at the individual institution level and also provide the capability for the public to interactively query the data; thus, bankers may compare themselves to other industry segments, specific competitors or groups of competitors. Mr. Waldrop said banking is a very transparent industry and that the transparency was a source of strength for it; he suggested that banks could view their expenditure on regulatory reporting as also being an investment because it provides useful information to the industry, investors and customers.

Mr. Waldrop also observed that the process for determining deposit insurance premiums was dependent on Call Report data and the vast majority of ratios used in the calculation come from Call Report schedules other than Schedule RC-O. He said that the law does not require the FDIC to assess insurance premiums quarterly, but that the FDIC had chosen to because it was believed that more frequent assessments tended to benefit banks that were struggling but improving because their premiums could be reduced sooner (than if there was a semi-annual assessment). Similarly, he said that quarterly assessments benefitted well-managed institutions by causing institutions that took on higher risk to pay higher premiums sooner.

Mr. Storch discussed the range of specific actions the Task Force was considering recommending to the FFIEC to address community bank regulatory reporting burden and the concept of a short-form Call Report. He said that, to lay the groundwork, the Task Force is identifying the specific Call Report items used to prepare the UBPR and in the offsite surveillance systems and the deposit insurance assessment system that had been discussed by Mr. Collier and Mr. Waldrop. He observed that Call Report data items that are often reported as zero may be identified as having little or no recurring need. Mr. Storch also said that the Task Force was considering accelerating the start of the next statutorily required review of Call Report data. He said that agency staff members who have been identified as users of specific Call Report data items would be challenged to prepare a robust justification that explains the use of each data item, whether it is needed quarterly, and the population of institutions from which it is needed. Mr. Storch said that the Task Force would prioritize the scope of the review by beginning with the Call Report schedules that are considered most burdensome, for example, Schedule RC-C on loans and leases. He said that data items for which there was insufficient justification for continued collection would be considered for elimination, less frequent collection, or the creation of new (or upwardly revised) reporting thresholds.

Mr. Storch reported that the Task Force could also consider the merits of a community bank version of the FFIEC 041 Call Report for institutions below a specified asset size. He said this short form could exclude schedules or items not applicable to institutions below the threshold, as well as items pertaining to activities or transactions that are not typically engaged in by community institutions. Mr. Storch said that, although the existing Call Report software already limits the Call Report schedules and items that must be completed to those specifically relevant to an individual institution, the starting point for institutions nevertheless is an 80-page report form. Thus, he said, a community bank Call Report may not in itself reduce the reporting burden, but it could reduce the size of the report form by 16 pages or more. Mr. Storch said that the Task Force could assess the merits of moving to a community bank Call Report starting in 2015 with the earliest implementation date likely to be the first quarter of 2016.

Mr. Storch said that the Task Force could also focus on which Call Report data items tend to need manual intervention and explore why community banks' core processing systems are not or cannot be integrated with their Call Report software. In this regard, he said that the Task Force could work with the ICBA to target what types of manual efforts are typically necessary, agency staffs could visit individual banks to observe their processes, and the agencies could publish a request for comment from the industry. Mr. Storch said that the use of targeted training could be used to reduce Call Report burden by reducing training costs. For example, he said, teleconferences and webinars could provide guidance on Call Report changes and areas of the report identified by community bankers as challenging. Mr. Storch noted that some previously identified burden-reducing changes had been delayed while the agencies were revising the regulatory capital reporting requirements and these changes could be issued for comment and then implemented later in 2015 or 2016. He said that the FDIC welcomed feedback from the Committee.

Several Committee members commended the FDIC and the FFIEC for undertaking the comprehensive review to reduce Call Report burden. Member Blankenship described Call Report issues at her \$400 million asset bank. She reported that it requires two experienced and efficient staff persons at least two days each quarter to complete the Call Report; she said that the work could not be assigned to less experienced staff and that training for Call Report preparation was not easy. Member Blankenship said the manual correction processes took the most time and that it was not possible to just hit a single key from the core processing system because sometimes its coding approach does not align with what the Call Report asks. She said that her bank concentrates on eliminating incorrect information because it wants to avoid having to re-file any Call Report. Member Blankenship indicated that if the FFIEC could eliminate the need for manual processes it would result in more accurate information being submitted because the manual processing allows for interpretation and error. Eliminating the need for manual processing would not only reduce burden on the bank, she indicated, but also on examiners who need to consult with bank staff about the decision making that occurred within the manual processing. Member Baronner agreed that accurate reporting was an important goal for community banks and that manual processing increased the likelihood data would become compromised. He suggested that the Task Force work directly with data processing vendors because many community banks had outsourced data processing in the last decade. Mr. Storch agreed that additional direct and formal discussions with vendors could be helpful. He noted that some recent Call Report proposals had been modified or withdrawn based on what vendors' systems could (or could not) support.

Member Castillo said that agency-sponsored training events would be very helpful. He reported that it was sometimes challenging to understand how the agencies intended for certain items to be classified and that review of the Call Report instructions and glossary did not always yield an answer. Member Castillo inquired if there were individual Call Report analysts available who could respond to specific questions about report preparation. Mr. Storch responded that there are Call Report analysts whose roles include confirming that incoming data is correct and/or properly explained, and answering questions from bankers about how transactions should be reported. He added that the Task Force regularly holds calls to try to make reporting instructions as clear as possible. Ms. Ellis added that the FDIC has about 15 Call

Report analysts who are familiar with the Call Report requirements and can field a wide variety of questions. Chairman Gruenberg said that the FDIC would seriously consider Member Castillo's suggestions.

Member Bryant said that the UBPR is an important tool, especially for small community banks, minority depository institutions, and community development financial institutions to create appropriate comparisons of themselves to selected peer groups. In response to a question from Member Bryant, Mr. Storch said that the Call Report does not ask respondents how much time was required to complete the report. Member Bryant advised that this would be useful information to gather; he suggested that examiners would have insight into how much time was required to complete the Call Report and later suggested that the survey at the end of a bank examination was an alternate source of the information. Members Blankenship and Saunders added that FDIC examination staff would also be good sources of information about where reporting errors occur within the Call Report. Mr. Storch said that the Task Force gets informal feedback from examiners on such issues, but agreed that it could be helpful to formalize the feedback process.

Member Lundy said he appreciated the panel's descriptions of how the Call Report data are used. He inquired about the interaction of the data collection and new loan loss reserve rules and efforts by the Financial Accounting Standards Board ("FASB") to implement quarterly mark-to-market requirements for loans and leases. Mr. Waldrop said that many changes in the Call Report and its increased complexity were driven less by bank regulators and more by the accounting profession and the FASB. He said there had been a trend to allowing institutions more flexibility to use different methodologies for valuations and reporting and a second trend to increase the focus on reporting fluctuations in values. Both of these trends, Mr. Waldrop indicated, made it more difficult to compare institutions to each other and to compare one institution over time. Mr. Storch noted that a challenge facing the Task Force was to keep the Call Report current with accounting changes and he provided further insights into the status of recent proposed changes to accounting rules.

Member Seleski emphasized the importance of timely and accurate data to the banking industry's ability to obtain capital and advised against reducing the reporting of quarterly financial data. He added that, with increasing automation, it should be possible to continue gathering the necessary information while reducing the burden of reporting. Member Savarese supported the rigorous reviews that new data requests to the Call Report are subjected to and inquired if the CFPB's requests were subject to the same standards. Mr. Storch said that the CFPB was a member of the FFIEC and its proposed additions to the Call Report data requests were subject to the same reviews as other agency requests. He added that the FFIEC agencies had been effective in distinguishing between necessary and less-than-necessary *new* data requests, but had not applied a similarly rigorous standard to data requests that had been present in the Call Report for longer periods. Director Norton agreed that the FFIEC agencies need to be mindful of distinguishing between data requests that are necessary and those that are merely convenient for an agency to request through the Call Report rather than through other paths available to them. Member Blankenship noted that, even if information is necessary, it is also important to inquire if it is needed quarterly and whether every bank needs to provide the information. Member Haskin observed that, although her bank may only need to complete 40

percent of the Call Report fields, it still must review the entire form in order to make that determination.

Member Haskin inquired whether the information gathered from banks had been useful in predicting the last financial crisis. Mr. Waldrop said that DIR uses Call Report data every quarter to look at trends and risks in banks' portfolio composition and to run forward-looking "what if?" scenarios. Ms. Eberley said that the FDIC continuously uses data collected to inform itself about trends and emerging risks. For example, she said that the FDIC had seen risk building in commercial real estate lending before the last crisis, and those observations prompted guidance that the FDIC issued in 2006, which itself followed many conversations and roundtables with banking groups. Mr. Collier noted that the focus of FDIC surveillance systems was on well-rated institutions to try to identify those that are starting to show characteristics of weaker-rated institutions; he observed that the surveillance systems did identify a number of banks that were moving in that direction before the crisis.

The Committee stood in recess at 11:59 a.m. and reconvened at 1:37 p.m. that same day.

Ms. Ryan then introduced the presenters for the panel, "Update on Cybersecurity," Doreen Eberley, Marlene Roberts, Senior Examination Specialist, RMS, and Donald Saxinger, Senior Examination Specialist, RMS. Ms. Eberley explained that the FFIEC agencies, through the Cybersecurity and Critical Infrastructure Working Group ("Working Group"), assessed the cybersecurity preparedness of over 500 community banks during 2014 and issued "FFIEC Cybersecurity Assessment General Observations" which summarized its findings. [The document, provided to the Committee, can be accessed at:

http://www.ffiec.gov/press/PDF/FFIEC_Cybersecurity_Assessment_Observations.pdf

Ms. Roberts reviewed the FFIEC's findings in five domains and Mr. Saxinger discussed how those findings related to existing FFIEC and FDIC guidance. Ms. Roberts noted that cybersecurity is just an element of information technology and that many elements of cybersecurity are already addressed within existing regulatory guidance; thus the discussion would not raise many new elements but would merely focus on specific elements already in place.

The first domain of cybersecurity preparedness the panel discussed was risk management and oversight which includes governance, allocation of resources, training and awareness. Ms. Roberts discussed the 2014 study's findings within this domain and also areas that financial institution management could consider to improve their preparedness. These considerations included, she said, having a process that ensured ongoing discussions about cybersecurity and vulnerabilities and making clear who is accountable for managing cyber risk. Mr. Saxinger reviewed various sources of guidance that address these issues, including a 1999 FIL titled "Risk Assessment Tools and Practices," the FDIC Information Technology ("IT") Examination Program, the IT Officers' Questionnaire, and customer information security elements of the Gramm-Leach-Bliley Act. The second domain of cybersecurity preparedness the panel discussed was threat intelligence and collaboration, or, how institutions acquire and analyze information about cyber threats. Ms. Roberts said that many institutions rely on reports from third-party providers or gather information when prompted by law enforcement or regulators. The FFIEC report suggested that institutions consider establishing a process for gathering and

analyzing threat and vulnerability information from multiple sources; incorporating cyber intelligence into risk management practices; determining what types of reports will be provided to the institution's board; and, identifying who is accountable for maintaining relationships with law enforcement representatives. Mr. Saxinger said the key concern was that financial institutions need to maintain their awareness of threats and vulnerability information and incorporate that knowledge into their risk management decisions. He reviewed a variety of sources that provide guidance on the subject including the Information Security Handbook.

The third domain the panel discussed was cybersecurity controls, including preventive controls, detective controls, and corrective controls. Ms. Roberts shared the FFIEC's general observations about controls and subjects that financial institutions should consider. She said that financial institutions should have: a process for determining and implementing preventive, detective, and corrective controls on their institution's network; procedures for reviewing and updating controls when there are changes in the IT environment; a process for classifying data and determining appropriate controls over the data based upon risk; and, a process for ensuring risk that has been identified through detective controls are remediated. Mr. Saxinger discussed various sources of guidance about controls and said the goal was to ensure that data and systems achieve appropriate levels of confidentiality, integrity and availability. He noted that IT examinations in the past may have focused on specific controls, but that the rapidly changing environment required regulators to take a risk management focus instead.

The fourth domain the panel discussed was external dependency management, which Ms. Roberts said assessed an institution's connectivity to (and oversight of) third-party service providers, business partners, customers and others. She said many institutions have processes to manage third-party relationships and document their connections, but said the report suggested they should also consider: how the institution connects to third parties and how those third parties manage their cybersecurity controls; what the third parties' responsibilities are during a cyber attack; and, how those responsibilities are outlined in incident response plans. Mr. Saxinger said the primary source of guidance on this domain was the FFIEC Handbook on Outsourcing Technology Services, but the topic was also addressed in the IT Officer's Questionnaire and the FFIEC Business Continuity Book. He noted that some traditionally low-risk systems from third-party connections have recently been avenues for cyber attacks into more critical or sensitive systems, so that institutions should be sensitive to that element.

The fifth domain the panel discussed was cyber incident management and resilience which includes incident detection, response, mitigation, and escalation. Ms. Roberts said many institutions have business continuity plans, but many need to expand those plans to address cyber events. The FFIEC report suggested that, prior to the event of a cyber attack, institutions should consider how they will respond internally, with their customers, with third parties, with regulators, and with law enforcement. Institutions should also consider if cyber incident scenarios are incorporated into the institution's business continuity and disaster recovery plans, and whether those plans are tested. Mr. Saxinger reviewed the applicable guidance and noted that preventive practices were not enough, that institutions need to be prepared for a cyber attack by planning and testing a response plan. He said the regulators were considering how they identify significant cyber events and noted that although regulators maintain relationships with law enforcement and intelligence, it is often bank-provided information that is the most helpful.

Ms. Roberts reported that the agencies are reviewing and updating their IT examination programs and that the focus will be on basic cyber hygiene and incident response and recovery. In response to a question from Member Savarese, Ms. Eberley said that the agencies would likely reemphasize some of their existing policies from a cyber perspective and that some new guidance might also be issued. Member Bryant observed that it was widely reported that large corporations had experienced cyber breaches and asked if the regulators had noticed the breaches trickling down to smaller institutions. Ms. Roberts said that she would speak only about general trends, not specifics; she reported the regulators had seen an exponential increase in cyber activity, especially against the financial services sector. After reviewing some new and continuing cyber attack trends, Ms. Roberts said that bad actors were scanning companies' systems daily looking for vulnerabilities, many of which are unknown until they are exploited and which may be in products which are widely used in the industry. She emphasized that basic cyber controls could prevent most attacks, but added that it was possible to have controls in place and still become a victim; for that reason, she said, institutions need to have appropriate incident response plans and a solid backup for system recovery. Ms. Eberley reiterated the importance of having strong controls in place and the continued applicability of the earlier guidance documents.

Member Savarese inquired whether the agencies had gathered any best practices from instances of cyber attacks and responses. Mr. Saxinger stated that the agencies appreciated being notified by banks about cyber incidents because it allows the agencies to track down lessons learned. He said that bank reporting had yielded some best practices the agencies had not previously identified, and that those practices had been incorporated into guidance the agencies subsequently issued. Member Lundy asked for an update on the FFIEC's interactions (on cyber security) with third party service providers that many community banks rely upon. Ms. Roberts reported that, although she could not go into specifics, a significant amount of information sharing had occurred in recent months and the FFIEC was encouraging service providers (as well as banks) to become members of various forums that share threat and vulnerability information. She added that the financial services industry is dependent on the telecommunications and energy sectors so that the FFIEC agencies were also engaging with those sectors to ensure they are resilient against cyber attacks.

Member Saunders suggested that community banks gather information about the costs associated with cyber attacks. Ms. Roberts agreed that would be important information to gather and suggested that it include soft costs such as personnel costs, as well as fraud losses and card reissue costs. She observed that law enforcement may decline to look at an incident unless it meets a certain dollar threshold; but that if banks establish they meet those thresholds, then they can file Suspicious Activity Reports and law enforcement can start putting patterns of crimes together. Member Bryant reported that about every 18 months, his institution invites an FBI cybersecurity representative to discuss recent trends. Ms. Eberley said that she thought that was a great best practice. In response to an inquiry from Member Savarese about banks auditing their service providers on their cyber preparedness, Mr. Saxinger said that the FFIEC agencies had reviewed many service provider contracts on this issue. He said that it would not be feasible for thousands of banks to audit service providers independently, but that contracts often allow the provider to create an audit that can be shared; he said banks would still need to determine if such an audit addresses its needs.

Ms. Ryan then introduced the presenters for the panel, “Recent Supervisory Guidance,” Rae-Ann Miller, Associate Director, RMS, Robert Burns, Deputy Director, RMS, and Jonathan Miller, Deputy Director, DCP. Ms. Miller discussed the interagency credit risk retention rule required by Section 941 of the Dodd-Frank Act. The final rule, she said, generally requires a sponsor of an Asset-Backed Security (“ABS”) to retain an economic interest equal to at least five percent of the aggregate credit risk of the assets collateralizing the ABS. Ms. Miller said the rule is intended to align the interests of ABS sponsors and investors, interests which were misaligned before the recent financial crisis, and which led to serious problems for the financial system.

Ms. Miller said an important exemption to the rule was one for ABSs that are secured solely by Qualified Residential Mortgages (“QRM”). Ms. Miller noted that the Dodd-Frank Act directed the agencies to define QRM, taking into consideration their underwriting criteria and product features, but not allowing the QRM definition to be any broader than that established for QM by the CFPB. She reported that the agencies chose to align the definitions for QRM and QM and described their rationale for doing so, including that the QM definition excludes many of the risk loan features that caused problems in the last crisis. Ms. Miller explained that aligning the definitions of QRM and QM would streamline compliance and costs and would provide the mortgage market with a uniform framework for underwriting and securitizing mortgages. She said the QRM definition would be reviewed by the agencies periodically and described other exemptions from the rule’s coverage. Ms. Miller stated that, in order to keep risk retention meaningful, the rule generally prohibits an ABS sponsor from hedging, transferring, or pledging their risk retention obligations. Ms. Miller said that the risk retention rule would be applicable to few community banks; specifically, community banks that merely originate or sell loans that are securitized (and are not ABS sponsors) do not have obligations under the rule concerning those originations and sales.

Ms. Miller also discussed an interagency final rule and an interagency proposed rule that generally would not be applicable to community banks. The liquidity coverage ratio rule is intended to improve the liquidity risk profile of large banking organizations and to strengthen the measurement and management of liquidity and risk at those organizations. The second, a proposed rule, applies to the most active participants in the over-the-counter derivatives market.

Mr. Burns said that the banking regulatory agencies had recently released the results of the Shared National Credit Annual Review Program and indicated that the risk in the shared national credit portfolio is almost exclusively within the leveraged lending component of it. He reported that agencies found high risk in the leveraged lending component, which suggested the existence of serious deficiencies in underwriting standards and risk management that were inconsistent with 2013 interagency guidance on the subject. Mr. Burns said the agencies recognized the importance of leveraged lending, but did not want originators to distribute poorly-underwritten and low-quality loans throughout the banking industry. He said the agencies recently supplemented their guidance on the subject and instituted a program of much more frequent reviews of the loans being originated to ensure that the originators had proper controls in place and are complying with the agency guidance. Mr. Burns observed that community banks do not generally originate this type of risk, but may acquire it by participating in the Shared National Credit Program (of which leveraged lending is one segment). He said that

regulatory expectation for community banks who participate in loans or purchase collateralized loan obligations is that they should engage in their own independent evaluation of the risks presented, applying the same standards of prudence as if the bank was originating the loans.

Mr. Miller then discussed a recent CFPB proposed rule concerning prepaid cards. He said the growth of prepaid cards was especially great among the unbanked. In 2013, he said, 12 percent of all U.S. households used a prepaid card (up from 10.1 percent in 2011), while 27.1 of the unbanked used prepaid cards (up from 18 percent in 2011). Mr. Miller said that about \$1 billion had been loaded onto prepaid cards in 2003, but the amount had grown to \$65 billion by 2012. He explained that, if finalized, the proposed CFPB rule would extend the Regulation E error resolution and fraud protection provisions to prepaid cards to level the playing field with credit and debit cards.

Mr. Miller then described the proposed requirements concerning periodic statements for prepaid cards; they may be in paper form or they can be provided electronically subject to certain additional requirements. He said the proposed rules are very similar to Department of Treasury rules applicable to payroll cards, in part because it is understood that many prepaid cards are already being used for payroll purposes. Mr. Miller also discussed the proposed rule's disclosure requirements for prepaid cards. Certain disclosures ("short form disclosures") would have to be made before purchase, including: the monthly fee; the fee per purchase; the ATM withdrawal fee; and the fee to reload cash. Other disclosures ("long form disclosures") would have to be made after purchase, he said; these would include all the short form disclosures, plus any other potential fees that could be imposed. Mr. Miller said that the proposed rule would require a card's program manager to disclose if the card does not carry deposit insurance. He noted that the rule would require the card companies to provide the disclosures to the CFPB which would post them all on its website to promote "one-stop shopping."

Mr. Miller also discussed the proposed rule's conditions for credit and overdraft features (noting that overdraft is treated as an offer of credit). First, he observed that prepaid card providers would not be allowed to market any credit features to card purchasers within the first 30 days of the card's registration. After 30 days, Mr. Miller said, credit marketing could be done if it is in compliance with the Truth-in-Lending Act and the Credit Card Accountability, Responsibility, and Disclosure Act ("CARD Act"). Thus, he explained, there would be limitations on how many fees could be charged in the first year, there must be notices concerning interest rates, card issuers could not require electronic payment, and billing could not occur more than once every 21 days. Mr. Miller said the proposed rules were not limited to plastic cards and would also be applicable to payment instruments contained in smartphones, for example. In response to a question from Member Haskin, Mr. Miller said that the proposed rule would apply only to general-purpose reloadable prepaid cards, not gift cards.

Member Seleski observed that the shared national credit market had grown from \$1 trillion to \$3 trillion in the last 5-6 years and inquired whether there should be a risk retention rule applicable to it. Ms. Miller explained that leveraged loans are the primary product that is packaged into collateralized loan obligations ("CLO") and would be covered under the risk retention rule to the extent that they are placed into CLOs, but that originators of leveraged loans that are not placed into CLOs are not covered by the risk retention rules because they are not

considered a sponsor of a securitization. Member Seleski expressed concern that many of the credits in the shared national credit program were criticized and asked if a bubble was brewing. Mr. Burns clarified that the leveraged loan portion of the shared national credit was approximately \$800 billion of the \$3 trillion shared national credit market, but comprised almost all of the criticized credits. Concerning risk distribution and a potential bubble, he said that the regulators are concerned about the banks that are holding the criticized credits as well as the originators. Ms. Miller said that the regulators tried to improve underwriting on leveraged loans underwritten by banks when they issued updated interagency guidance in 2013; however, the 2014 review found that the originators were not following the 2013 guidance. Ms. Miller and Mr. Burns indicated that the OCC, the Federal Reserve, and the FDIC all shared a high level of concern and were jointly undertaking monthly reviews of the leveraged loan portion of the Shared National Credits to improve the situation. Mr. Burns said that shared national credits can be good investments and the agencies did not want to discourage their prudent use, but agreed with Member Bryant that purchasers needed to be aware that they were purchasing risk. He added that some firms who were originating the leveraged loans were distributing all of it into the financial market although they themselves rate them as criticized credits. Member Bryant recommended that the agencies share information about the shared national credits with various organizations that represent community development financial institutions, minority depository institutions, and community banks because those organizations are often targeted for sales presentations.

Member Haskin suggested that the new FASB plan concerning loan loss reserves and the newly expanded Home Mortgage Disclosure Act requirements would be helpful topics for future Committee discussion. Member Blankenship suggested that payment systems that operated outside of the FDIC-insured payment system would be another useful topic, as well as new technologies being introduced to respond to cyber crime.

Chairman Gruenberg said that he thought that the staff presentations and Committee member contributions made the day a meaningful and informative experience. He expressed his gratitude for the service of the departing Committee members. Member Savarese thanked Chairman Gruenberg and the FDIC for their support of community banking.

There being no further business, the meeting was adjourned at 2:53 p.m.



Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
And Committee Management Officer

Minutes
of the
Meeting of the FDIC Advisory Committee on Community Banking
of the
Federal Deposit Insurance Corporation
Held at the
Federal Deposit Insurance Corporation William Seidman Center
3rd Floor Auditorium
Arlington, Virginia
Open to Public Observation
November 20, 2014 — 9:04 A.M.

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

[Redacted Signature Box]

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

November 20, 2014