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

April 2, 2015 – 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: Cynthia L. Blankenship, Vice Chairman and Chief Operating Officer, Bank of the West, Grapevine, Texas; Pedro A. Bryant, President and Chief Executive Officer ("CEO"), Metro Bank, Louisville, Kentucky; Roger Busse, President and CEO, Pacific Continental Bank, Eugene, Oregon; Leonel Castillo, President and CEO, American Bank of Commerce, Provo, Utah; Christopher Emmons, President and CEO, Gorham Savings Bank, Gorham, Maine; Jack Hartings, President and CEO, The People Bank Corp., Coldwater, Ohio; Jane Haskin, President and CEO, First Bethany Bancorp., Inc., Bethany, Oklahoma; Mark Hesser, President, Pinnacle Bank, Lincoln, Nebraska; James Lundy, CEO, Western Alliance Bank, Phoenix, Arizona; Arvind Menon, President and CEO, Meadows Bank, Las Vegas, Nevada; Mary Ann Scully, Chairman, President and CEO, Howard Bank, Ellicott City, Maryland; David Seleski, President and CEO, Stonegate Bank, Fort Lauderdale, Florida; Gwen Thompson, President and CEO, Clover Community Bank, Clover, South Carolina; John Tolomer, President and CEO, The Westchester Bank, Yonkers, New York; and Derek Williams, President and CEO, First Peoples Bank, Pine Mountain, Georgia.

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

Corporation staff who attended the meeting included: Willa M. Allen, Ruth R. Amberg, Steven O. App, Valerie Best, Luke H. Brown, Richard A. Brown, Kitty Chaney, Carolyn D. Curran, Christine M. Davis, Robert C. Drozdowski, Doreen R. Eberley, Bret D. Edwards, Diane Ellis, Lekeshia Frasure, George E. French, Kyle L. Hadley, Christopher L. Hencke, William H. Henley, Jr., Matthew I. Kepniss, Alan W. Levy, J. Mark Love, Christopher Lucas, Brendan R. Mazur, Roberta K. McInerney, Stacy T. Meisel, Jonathan N. Miller, Mark S. Moylan,

Christopher J. Newbury, Thomas E. Nixon, Jessica Nye, Elizabeth Ortiz, Richard J. Osterman, Mark E. Pearce, Sylvia H. Plunkett, Marlene M. Roberts, Floyd Robinson, Claude A. Rollin, Barbara A. Ryan, Munsell W. St. Clair, Martin P. Thompson, James C. Watkins, Cottrell L. Webster, Mindy West, and Charles Yi.

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, including seven new members, and observed that the Committee was a great resource for the FDIC. He provided an overview of the day's agenda. First, there would be an update on recent developments in the FDIC's community bank initiative, then a second panel would discuss the FDIC's efforts to reduce regulatory burden pursuant to the interagency process required by the Economic Growth and Regulatory Paperwork Reduction Act. A third panel of particular interest to community banks, Chairman Gruenberg said, would discuss the operation of the FDIC's Professional Liability Program and its oversight by the FDIC Board of Directors. The fourth and fifth panels would discuss cybersecurity and the retail payment system. Finally, he said there would be a discussion of recent supervisory guidance on topics such as brokered deposits, interest rate risk ("IRR") and the qualified mortgage rule promulgated by the Consumer Financial Protection Bureau ("CFPB"). Chairman Gruenberg introduced Chief of Staff Barbara Ryan who moderated the day's proceedings.

Ms. Ryan introduced the panelists for "Update on Community Bank Initiatives," Doreen Eberley, Director, Division of Risk Management Supervision ("RMS"), Mark Pearce, Director, Division of Depositor and Consumer Protection ("DCP"), and Diane Ellis, Director, Division of Insurance and Research ("DIR"). Ms. Eberley said that RMS was reviewing its pre-examination information request program to make sure it is as efficient as possible. She noted that RMS and DCP had reworked the pre-examination request letter process in 2013, but that RMS was still receiving some feedback that bankers were unable to determine how examiners used some of the information that had been requested; she recognized that, if one cannot tell how information is being used, it may feel unnecessary to gather it. Ms. Eberley reported that she had established two working groups – one a management group of field supervisors and another one at the staff level- to review the whole process for improvements. She said she established the working groups about one month earlier and would keep the Committee updated on the review's progress.

Regarding the FDIC's technical assistance program, Ms. Eberley reported that RMS was working on two new videos on cybersecurity; one is a basic introduction to cybersecurity and the other focuses on vendor management. She indicated that RMS is also updating previously released videos on IRR and corporate governance. Finally, Ms. Eberley said that the FDIC had developed three new vignettes in the previously released Cyber Challenge series. The three vignettes present common cyber issues that institutions face, she said, and provide challenge questions that allow a bank's management or board to consider how they would respond. Ms. Eberley noted that the series provides a reference guide that directs bankers to answers and guidance in the Federal Financial Institution Examination Council's ("FFIEC") information technology ("IT") Handbooks. Finally, Ms. Eberley described a survey that is being developed for users of technical assistance videos to obtain feedback on the video content, the range of topics, the utility of the videos and how the videos are being used.

Mr. Pearce said DCP shared the goal for the technical assistance videos to be helpful and tailored to community bank needs. He added that, if there are regulatory changes that community banks need to respond to, the FDIC wanted its videos to be updated to help banks manage those responses. Mr. Pearce noted the CFPB was considering changes to its definitions of what qualifies as a rural institution which may be beneficial to community banks and that the changes would be discussed later in the meeting. Mr. Pearce reported that DCP had released a new technical assistance video concerning loan originator compensation; he observed that the underlying rule prohibits a loan originator in the mortgage from receiving compensation that is based on the terms of the transaction or a proxy for those terms. He said that the video describes the technical elements of the rule such as the definitions of loan originator, compensation, and proxy, but also discusses exceptions to the rule (such as a *de minimis* exception), that may be particularly beneficial to community banks. Mr. Pearce described a second new video on mortgage servicing for small mortgage servicers. He said the video focuses on the definition of a small servicer and the exceptions to the requirements applicable if one is a small servicer.

Ms. Ellis described four research papers pursuant to the Community Bank Research Initiative that the FDIC hopes to complete in 2015. The first paper will focus on small closely held banks; it will identify the characteristics and performance of this group of institutions and explore some of their strategic opportunities as well as challenges such as management succession, and recruiting and retaining qualified employees. Ms. Ellis described the second paper as focusing on the cost functions and economies of scale among community banks. She said the current paper would update work done in 2012 and take a more statistical approach to the problem of distinguishing between fixed and variable costs, and regulatory and non-regulatory costs of community banks. The third paper will focus on mutual ownership of community banks. She said the study will parallel to some extent the FDIC study prepared in 2014 concerning minority depository institutions, it will highlight structural changes among mutual institutions, and will look at their geographic distribution, financial performance and balance sheet characteristics. The fourth paper will consider the structural profitability of community banks with a focus on those banks that consistently outperform and underperform the averages. Ms. Ellis indicated the study will review where such banks are located, their lines of business, what things they specialize in, and the areas of the income statement where they outperform or underperform. She said a goal of the study would be to identify some of the competitive challenges and unique opportunities these banks face.

Member Seleski complimented the research projects; he said that the profitability information would be useful, but was concerned that the data available would not be detailed enough to make the most useful distinctions; for example, the data may not be able to answer what comprises non-interest income. Ms. Ellis agreed that the Call Report data was sometimes insufficiently detailed to answer some questions, but noted that researchers were coordinating with bank supervisory staff to get insights into some of the data. Member Hesser noted that the Committee was not suggesting that the Call Report be expanded. In response to a comment from Member Blankenship about family owned institutions, Ms. Ellis said the Call Report does not provide data about family ownership, but reported that case managers and field supervisors were helping gather data by answering a standard set of questions concerning ownership type. Chairman Gruenberg noted that family owned institutions make up a distinctive and substantial

segment of community banks so that it would be worthwhile to develop a better understanding of them and their particular issues. Member Blankenship applauded the work on family owned community banks and suggested that an important inquiry would be about their plans for the future; she said that this sector of community banking might be particularly at risk from management succession and regulatory burden issues. Member Bryant thought that the research projects would be extremely helpful for smaller banks as they conduct strategic and succession planning. Member Williams agreed that research into cost, function, economies of scale, and structural profitability would all help the smallest of the small banks, a segment that has not received sufficient attention despite its cumulative size.

Member Williams also reported that he had heard industry feedback that the pre-examination preparation for safety and soundness examinations was much improved and that examinations were proceeding more efficiently as a result. Member Busse agreed and reported that his bank's recent safety and soundness and compliance examinations had gone smoothly. Ms. Eberley said she appreciated the feedback. Chairman Gruenberg later said that he appreciated the exam process feedback, noting that Ms. Eberley and RMS put enormous effort into ensuring that the exam process across the country consistently followed the FDIC's priorities. He added that the FDIC welcomes all types of feedback and tries to respond positively to it. Member Hartings complimented the technical assistance videos on loan originators, ability to repay, and qualified mortgages.

In response to a question from Member Tolomer, Ms. Eberley clarified that the FDIC's research was focused on closely held banks and was not limited to family owned institutions. Member Castillo suggested that the FDIC's research could explore if specific new regulations had caused banks to experience structural changes in revenue sources and/or changed behaviors over the last five to seven years. He expected that extensive regulatory change has impacted banks' operations, but was interested what the data might reveal. Ms. Ellis agreed and said a key issue would be how cost functions have changed over time. She described what the FDIC found concerning various economies of scale (or the lack of them) in 2011, but said that the FDIC would like to expand on that study and find if there was a trend over the years. Member Blankenship emphasized the usefulness of research into the various subsectors of community banks which are often lumped into a single category. She expressed the belief that the FDIC's examination process would be improved after it gains greater knowledge about such subsectors because it would help examiners recognize that some differences among community banks are due to their different structures and strategic plans. In response to a question from Member Bryant about the definition of community banks for the FDIC's research purposes, Ms. Ellis noted it is not a strictly size-based threshold, but is based on a bank's business model and its geographic dispersal among other characteristics. She observed that 94 percent of community banks have below $10 billion in assets, but that some larger institutions are also considered community banks under the FDIC's research definition.

Ms. Ryan introduced the speakers for the panel titled "Update on the FDIC's Regulatory Review under the Economic Growth and Regulatory Paperwork Reduction Act ("EGRPRA"), Roberta McInerney, Deputy General Counsel, Legal Division, Ruth Amberg, Assistant General Counsel, Legal Division, and James Watkins, Senior Deputy Director, RMS. Ms. McInerney noted that the EGRPRA review process was discussed in the previous meeting and provided an

overview of the process. She said the EGRPRA review requires the FDIC, the OCC and the Federal Reserve to review their regulations at least once every ten years by publishing their rules in categories and requesting public comment to identify rules that are outdated or unnecessary. Ms. McInerney reported that the agencies divided their regulations into 12 categories that would be published in four *Federal Register* notices before the end of 2016. She noted that the first three categories of regulations were published in 2014 (applications and reporting; powers and activities; and international operations) and that the agencies received 40 comments that were being reviewed. The second notice, which included the categories of banking operations, capital and the Community Reinvestment Act "CRA"), was still open for comment, and the agencies encouraged the public to provide input. She said the agencies were holding six outreach sessions around the country to seek direct input from bankers, consumer and community group representatives, and other interested parties.

Ms. McInerney provided an overview of some of the comments the agencies had received and responses to them. In response to public comment, the agencies decided to include recently issued regulations in the EGRPRA review. In addition, she said the agencies would also welcome comments on regulations issued by the CFPB and the Financial Crimes Enforcement Network ("FinCEN"). Although the EGRPRA agencies would not be able to take direct action on such regulations, Ms. McInerney explained that the agencies would share them with the appropriate regulators and expected to find such comments helpful as they conducted the EGRPRA review and their bank supervisory activities. She noted that Chairman Gruenberg supported reducing burden as soon as the agencies could without waiting until the end of the EGRPRA process. Consistent with that direction, she reported that, in response to feedback about confusion in the *de novo* bank process, the FDIC reviewed its existing policies and issued new Questions and Answer documents to address that process. Similarly, in response to feedback about the Call Report's burden, especially on community banks, Ms. McInerney reported that the FFIEC was exploring ways to streamline the Call Report. She noted that, in response to public comments, the FDIC revised its policy on the use of limited liability companies to significantly reduce the number of applications necessary. Finally, Ms. McInerney said that some commenters expressed concern about the cumulative regulatory burden facing community banks overall. She explained that whenever the FDIC is required to impose regulatory requirements, it carefully considers the burden with a special focus on community banks. Ms. McInerney encouraged bankers to participate in the EGRPRA review process.

Mr. Watkins discussed five recurring themes being raised in the EGRPRA process. The first was Call Reports. Bankers, he indicated, expressed the desire to streamline the Call Report or eliminate certain schedules. Mr. Watkins said that the agencies are reaching out to better understand the processes banks follow to prepare their Call Reports and regulatory filings. The agencies are also evaluating training and technical assistance initiatives to help bankers prepare Call Reports. Examination frequency is a second theme being raised in the EGRPRA process. Mr. Watkins said some commenters recommended changing the frequency of examinations established in statute by raising the exception threshold for small institutions from $500 million to $1 billion or more, and increasing the examination interval to 24 months. Mr. Watkins said that some commenters suggested a longer examination cycle could be supplemented by targeted periodic reviews; that greater scheduling flexibility could be exercised; and that regulators could use more electronic measures to obtain and share information.

A third burden reduction theme Mr. Watkins discussed was appraisal thresholds. He reported that some banks commented that the appraisal regulation requirement to obtain an outside or certified appraisal on loans of $250,000 or more is out of date and should be raised to a higher level to account for changes in the economy and real estate costs. The fourth theme was the burden related to Bank Secrecy Act ("BSA") requirements. Mr. Watkins said commenters recommended raising the threshold for currency transaction reporting from $10,000 to $20,000 or higher, raising the recordkeeping threshold for the purchase of monetary instruments from $3,000 to $10,000, and also allowing more exemptions for certain customers. The fifth theme related to communications. Mr. Watkins said bankers asked the FDIC to continue to promote open and regular lines of communication, in particular to ensure that supervisory expectations meant for large banks are not imposed on community banks. He observed that the FDIC was reaching out to its examination staff as well as banks to avoid that outcome. Mr. Watkins also noted that the FDIC was issuing technical assistance videos to promote useful information on regulatory issues and changes for bank directors, officers, and employees; it also maintains a regulatory calendar so that bankers can see the landscape for new requirements. Mr. Watkins echoed the intention that the FDIC would reduce burden as the opportunity arose rather than waiting for the end of the EGRPRA process.

Member Castillo inquired about the process for considering changes to appraisal thresholds, BSA requirements and the Call Report. Mr. Watkins indicated that the process depended on the source of the regulatory requirement. If the FDIC issued the requirement, it could take action regarding it, but if the recommended change required modifying a statute, the FDIC would work with other agencies to make recommendations to Congress. If a requirement is established by another agency, such as BSA requirements established by FinCEN, the FDIC would share its insights and feedback from bankers with the other agency. He added that the FDIC's input would be helpful to the other agency's deliberations about its requirements. Member Lundy said that poor appraisals contributed to the previous financial crisis and that one good outcome of that crisis was the improvement in appraisal standards. He indicated that since the banking industry had embraced the value of good appraisals, their recommendations about raising thresholds should be taken seriously.

Member Hartings suggested that the FDIC consider statistically analyzing institutions that became troubled or failed over the last ten years for insights on best employing FDIC examination resources. Mr. Watkins said that he believed there is real value in comprehensive, periodic examinations to ensure a bank that is rated as a CAMELS "2" remains, in fact, a 2-rated bank and is not drifting, taking on new risks, or expanding into areas where it does not have expertise. He said identifying issues early and providing timely feedback to the bank is critical to ensuring a healthy banking environment. Mr. Watkins added that every failed bank and its supervisory history are examined by the FDIC Board. Member Blankenship asked if the FDIC had considered reducing the frequency of examinations based on comprehensive audits that banks employ; she noted that her bank hires third-party firms to do loan reviews as well as BSA and compliance reviews. Mr. Watkins said that third-party reviewers' work can sometimes fall short of what is needed and there is benefit to periodic examinations conducted by examiners who have been extensively trained by the FDIC for that purpose. Mr. Watkins said the FDIC does consider a bank's audits and their quality and then adjusts how deep and extensive the

FDIC examination needs to be based on that evaluation. Member Scully inquired whether the FDIC had reviewed data about banks that were rated "1" or "2" and then dropped precipitously for insights into how the FDIC could best focus its resources. Mr. Watkins responded that the FDIC engages in extensive off-site analysis of bank data and looks, for example, at balance sheet growth, changes to management or a business plan, elevated levels of past due or problem loans, concentrations, and IRR. When the FDIC identifies heightened risk, he explained, it may prompt a telephone call to the bank or an on-site visit.

Member Menon inquired if it is possible for the FDIC to rely on more visitations rather than full scope examinations, especially for higher rated banks. Mr. Watkins said that some earlier attempts to streamline examinations had not always been successful; he observed that it is important to identify bank problems at an early stage to avoid big losses and indicated that streamlined examinations might miss some areas that warrant closer examination. Member Williams suggested that there might be a tradeoff between Call Reports and examination cycles; if banks continue rigorous quarterly reporting, then it might warrant a longer examination cycle, or, if banks stay on the same examination cycle, the FDIC could consider alternate quarter limited scope Call Reports. Mr. Watkins said the FDIC welcomed suggestions on streamlining Call Reports or specific examples of where bankers thought the FDIC was spending more time than was necessary. Member Williams said that the Independent Community Bankers of America had proposed that "1" and "2" rated banks that fit a certain risk profile could engage in full Call Reporting in the June and December quarters, but have a more limited Call Report in March and September.

Member Bryant recommended a paper titled "The Future of Community Banking" which, he said, studied banks from 2006 to 2014 that had gone from highly rated to poorly rated, but had resumed a higher rating; he said that his bank's board of directors found it useful for "lessons learned" in the recent crisis. Member Blankenship suggested that, if the FDIC engaged in additional off-site statistical analysis of banks, it could exercise more flexibility in customizing the examination cycle for banks which were not experiencing changes that increased risk and were engaging third-party analyses of their businesses. Mr. Watkins observed that FDIC examinations are risk focused; examiners directed their review function to areas where they had identified higher levels of risk. He welcomed thoughts on improving risk focusing. Member Lundy made reference to the previously discussed improvements in pre-examination preparation and suggested that the FDIC make similar improvements in targeted and non-full scope examinations. He also suggested that the FDIC could communicate what its expectations were when banks experienced various risk increasing situations such as new business lines, rapid growth, or an economic decline.

Member Seleski indicated that bankers generally welcomed input from examiners that looked at the bigger picture and asked broader questions concerning their banks' risks. He contrasted such a consultative approach with a "gotcha" approach where examiners focus on small regulatory infractions that would not affect the institution's well-being. Member Seleski said that, after his bank had made acquisitions, the FDIC conducted a visitation that looked at integration issues from a high level and said that his bank found the visitation very helpful. He contrasted that with a five hour meeting discussing $20,000 loans in a $2.2 billion institution. Member Hesser provided an example of how examination burden can be reduced. He said that

his bank has multiple charters and said that examiners coordinated targeted examinations of capital markets so that there was only one examination rather than four similar ones.

Member Busse agreed that pre-examination scope discussions had been helpful in focusing examinations and said that it dovetailed into the idea of a focused risk assessment of the institution. He also noted that when a bank has an area of specialization, the FDIC can send in an examiner to concentrate on that specific area; he said that such examinations became very focused, meaningful and consultative and he encouraged the FDIC to continue that approach. Member Scully acknowledged that the FDIC could face criticism if it moved away from a "one size fits all" approach to examination, but recommended that, if the FDIC took a somewhat differentiated approach, it would be beneficial. Member Hartings said community bankers are passionate about examination burden because an examination requires two weeks of the time of the bank's highest level staff, and during that time, other bank priorities are suspended. He added that a 12 month examination cycle actually provided only 8 months to focus on his business since he had to respond to pre-examination requests and final examination results did not occur immediately; thus, it was important whether the examination cycle was 12 or 18 months. Member Menon observed that community banks have limited staff and time to devote to examinations and recommended that the FDIC try to accomplish more work off-site.

Member Williams suggested that banks would appreciate more feedback about the subsequent use of BSA required reports; at present, he said, the work appeared thankless and for no clear benefit. Member Blankenship commended the FDIC for considering moving toward a more risk based examination approach and acknowledged that the FDIC's approach had not been static. She observed that new technology was creating a sea change in community banks' business models and that, similarly, the FDIC might consider changing the model in which they conduct examinations. Mr. Watkins said that the Committee members' feedback was very helpful. He suggested that a future Committee meeting could further discuss FDIC's off-site reviews and how they interact with examinations.

The Committee stood in recess at 10:21 a.m. and reconvened at 10:50 a.m. that same day.

Richard Osterman, Deputy General Counsel, Legal Division, Floyd Robinson, Assistant General Counsel, Legal Division, and Bret Edwards, Director, Division of Resolutions and Receiverships ("DRR") presented the panel titled, "The FDIC's Professional Liability Program" ("PLP"). Mr. Osterman provided context for the PLP, noting that the FDIC acts in two capacities. In its corporate capacity, he explained, the FDIC supervises state nonmember banks and insures financial institutions; in its receivership capacity, it acts as receiver for failed banks and thrifts to liquidate assets and pay claims. Mr. Osterman noted the FDIC's PLP arises from its receivership capacity. In the most recent financial crisis, he said, over 510 banks failed, with a peak of 157 failures in 2010, 18 failures in 2014, and 4 so far in 2015; by comparison, 2,300 institutions failed in the crisis of the late 1980's to early 1990's.

Mr. Robinson explained that the FDIC has litigation authority for its civil actions, in other words, it is not required to consult with any other federal agency before bringing a civil claim. He also observed that the receiver succeeds to all rights and powers of the failed institution and its shareholders, depositors and officers, and also owns all derivative claims. Mr.

Robinson said that statutes of limitations apply to these claims, the FDIC has three years to bring a tort claim and six years to bring a breach of contract claim; those time periods begin to run from the date the bank fails, he noted, provided that the claims had not lapsed under applicable state law before the failure. Tort claims, he said, are claims for negligence, gross negligence, breach of fiduciary duty, legal, accounting, or appraisal malpractice. Breach of contract claims are claims the FDIC pursues when attempting to recover against a fidelity bond; in this crisis they also included closing protection letter claims in mortgage fraud cases. Mr. Robinson said that the FDIC also pursued Residential Mortgage Backed Securities ("RMBS") claims for the first time in the most recent crisis.

Mr. Osterman discussed a variety of safeguards to ensure that the FDIC pursues meritorious, cost-effective claims. First, the FDIC Board of Directors issued a policy statement in 1992 that makes clear that FDIC lawsuits against bank directors and officers are instituted only after thorough FDIC investigation. He explained that the DRR and the Legal Division jointly investigate if there are valid claims and that these investigations typically take about 18 months. A decision to pursue a case, Mr. Osterman said, is subject to a multi-level review including senior DRR and Legal Division officers, and then must be approved by the FDIC Board. Mr. Osterman said that, before a case is filed, the FDIC attempts to contact potential defendants to explore settlement. The FDIC is actively involved in the management of PLP litigation, he explained, using approximately 50 in-house attorneys to oversee outside counsel. Moreover, cases are subject to ongoing review by FDIC attorneys who are always available to discuss cases. The public may access information about the PLP on the FDIC's website.

Mr. Robinson discussed how the FDIC determines if a case is meritorious. He explained that the FDIC looks at the applicable state law, good corporate governance policies, the execution of those policies, and how boards of directors responded to criticism (from regulators, and accountants and consultants hired by the bank). Mr. Robinson said the FDIC considers the duties of directors and officers and whether they were breached. These duties include: fiduciary duties of care and loyalty; a duty to supervise core bank functions; a duty to review information about the bank's operations and performance; and a duty to take prompt action to remedy weaknesses and respond to supervisory criticisms. Mr. Robinson said that the FDIC's website and technical assistance videos provide information outlining directors' and officers' duties. He noted that the standard of care is established by state law and discussed the ability of the FDIC to pursue simple negligence claims. Mr. Robinson discussed the Business Judgment Rule, which provides limited deference to directors' and officers' decisions if they were made: on an informed basis; in the best interests of the bank; in good faith; and free of conflicts of interest;.

Mr. Osterman discussed how the FDIC determines if a case is cost-effective to pursue, noting that recoveries come primarily from available insurance and personal assets. He observed that, early in the recent crisis, insurance policies had virtually no exclusions with respect to potential claims by the FDIC, but that more policies had such exclusions as the crisis developed. Mr. Osterman said that the FDIC issued a 2013 Financial Institution Letter to alert bankers to this changed situation. Regarding personal assets, he said that the FDIC's claims are often for much more than a defendant can pay so the FDIC may settle a claim based on an ability to pay (after receiving a required defendant's financial statement). Mr. Osterman then discussed various charts that had been provided to the Committee. One chart showed peaks in the number

of cases that occurred approximately three years after the peaks of failures in the last two crises. He observed that the FDIC currently has about 100 professional liability cases filed, of which about 60 are director and officer cases.

Mr. Edwards observed that the PLP is cost effective, between 1986 and 2014 its recoveries were just over $8.6 billion compared to its expenses of just over $2.1 billion. He noted that the period for recoveries lags the period for expenses by several years and that large recoveries in any given year can skew the statistics so that it is best to look at recoveries and expenses over an entire bank failure cycle. Mr. Edwards stated that the expenses that he spoke of included outside counsel, outside investigation costs, in-house counsel and investigation costs and accounting expenses. Mr. Osterman observed that most recovered funds are returned to the Deposit Insurance Fund which, in turn, lowers the cost of deposit insurance for well-run banks. He also described actions the FDIC takes in its corporate capacity, including enforcement actions, referrals to the Department of Justice, awards of criminal restitution to the FDIC and actions by the Inspector General that are coordinated with the Department of Justice.

Member Seleski said that his bank, which has acquired several banks, including failed institutions, found that banks whose boards were composed of people who had served on more than one bank board were generally better run. He expressed concern that the potential liability of being a bank board member might discourage qualified people from serving in that role. Member Seleski then provided the hypothetical example of a retiring bank president who is wealthy and questioned whether such a person would be willing to risk being a board member for $500 or $1,000 per month. He asked if the FDIC had ever inquired among bank board members whether they would be willing to join another bank board. Mr. Osterman said the FDIC shared the concern about a potential chilling effect, but he observed that: 1) most banks do not fail so that there are no lawsuits; 2) in most failed banks, the FDIC does not bring lawsuits; and 3) if a bank director does their job, there is nothing for them to worry about. Member Bryant said that his bank would experience board member retirements in the next few years and his observation was that newer, younger board members were envisioning short-term, perhaps three year, commitments rather than 15 to 30 year commitments to the bank. He said that FDIC resources for directors, including the video on fiduciary responsibilities, were helpful in informing board members (and potential ones) about their responsibilities. Member Bryant indicated that it is important to a bank's well-being that board members accept their fiduciary responsibilities and take an active role.

In response to Member Tolomer's inquiry if the FDIC had detected patterns among the bank failures, Mr. Osterman said the Inspector General conducted material loss reviews of many failed banks and that many failures combined a very high growth rate with a failure to comply with the bank's own policies and procedures. Chairman Gruenberg said that the FDIC board of directors scrutinizes all PLP cases before they are approved; he noted that FDIC staff does not bring close calls to the board and that the fact patterns tended to involve rather egregious failures to follow a bank's own standards and procedures. Chairman Gruenberg observed that holding bad actors accountable was important for the industry, as well as the FDIC, because when persons do not fulfill their duties to a bank, the rest of the banking industry that do follow the rules must pay the price. Chairman Gruenberg agreed that it is critically important for banks to be able to attract qualified people to serve on their boards and there was a concern about

potentially discouraging such people; he indicated, however, that his perception was that board members who did their jobs in a reasonable fashion did not put themselves at risk. Mr. Osterman agreed and observed that the FDIC issued its 1992 policy statement in response to concerns about a potential chilling effect. He said that the FDIC is careful concerning its responsibilities because it is in the FDIC's interest, as well as banks', that qualified people are willing to serve.

Member Blankenship indicated that it appeared that directors from small institutions were more likely to be sued than directors from large institutions and inquired if the FDIC had analyzed that issue. Mr. Osterman said that the FDIC investigates every bank failure with the same standards applied to every bank. He said he thought that the main issue was whether a bank failed because only failed banks are examined for these types of lawsuits; he noted that more small banks failed than large ones. Mr. Osterman observed that the FDIC brought actions in several large failed banks such as IndyMac, Washington Mutual and Downey Savings. Mr. Robinson added that, of the 510 failures in the recent crisis, only nine institutions had assets over $10 billion. He observed that, working just from his memory, there were large director and officer cases in at least five of those, or in over 50 percent of the larger failures; he contrasted this rate against the more general statistic that the FDIC brings such suits in significantly less than half of all failures. Member Blankenship observed that there has probably been a misconception about the subject and suggested it would be helpful for the FDIC to communicate that the size of a bank does not affect the likelihood of being sued. Mr. Osterman agreed that it was important to clarify these issues and conduct this type of communication. Member Hesser said there was industry frustration because some of the largest institutions caused losses through the Troubled Asset Relief Program, but avoided failure; thus, the institution was able to pay fines for misconduct and no individuals were sued. This communicated to potential directors that it made sense to be a director of an institution that was "too big to fail," he said.

Member Lundy inquired if and how the FDIC learned about the effectiveness of its supervisory process from the PLP lawsuits that it brought. Mr. Osterman said the Inspector General conducted material loss reviews of many of the banks that failed and the effectiveness of supervision in those cases. He said those reviews sometimes suggested that earlier enforcement action, cease and desist orders, and identifying underwriting flaws may have helped. Mr. Osterman said the FDIC uses the review process to adjust its supervisory program. In response to a question from Member Lundy, Mr. Osterman observed that PLP recoveries were a very small percentage compared to the entire loss to the Deposit Insurance Fund.

Member Bryant suggested that persons being considered for board positions in community banks misperceived what their potential liabilities would be because national media report on problems and fines at large banks and the distinctions between large and small banks are lost. Chairman Gruenberg said that he shared the concern about misperceptions about the risk of serving on the board of a community bank. He observed that the banks that failed usually had a strikingly different profile from the large majority of institutions that did not fail; they often experienced rapid growth, engaged in high-risk activities funded by volatile deposits and had boards who were not paying attention. Chairman Gruenberg contrasted those failed banks with the 6,000 smaller institutions that did not fail during the last crisis. He suggested that a person serving on the board of a bank that pursued a traditional community banking model and did his or her job would experience a low risk of being sued. Chairman Gruenberg said he

wanted the FDIC's processes about bringing these cases to be transparent to help make that distinction clear. He noted that the FDIC had published a number of resources about director responsibilities and invited suggestions about other ways the FDIC could be helpful. Member Blankenship suggested that the FDIC's directors' videos could include real life examples of how directors have gotten into trouble to show where vulnerabilities might be and what questions directors need to ask. Member Scully indicated that, if many lawsuits resulted from directors' sins of commission rather than omission, the FDIC's videos could emphasize that point. Member Williams suggested that directors' comfort with their responsibilities would be increased if both the bank and FDIC resources helped explain to directors what is expected of them; he noted that it is a bank's responsibility to educate their directors about the bank's policies and practices. Member Bryant indicated that the FDIC's inquiries during the examination process regarding the qualifications of senior management and directors, and their professional development, helped board members be proactive in understanding their responsibilities, including the necessity of hiring qualified management. Member Haskin complimented the FDIC's directors' video series. She said that her bank's directors took their liability seriously, and although they are seasoned, the videos help them be aware of current risks such as cybersecurity. Member Haskin said the videos have prompted directors to ask management to provide briefings to the board about how they are handling such risks.

Ms. Eberley provided an "Update on Cybersecurity" for the Committee. She first described the various cybersecurity resources that the FFIEC has made available to banks and the steps the FFIEC agencies have taken to identify and address current requirements in the area. Ms. Eberley noted that the FFIEC agencies provided a webinar to more than 5,000 CEOs titled, "What Do CEOs Need to Know About Cybersecurity?" which was also made available as a video on the FFIEC website. She said the FFIEC agencies also issued statements about cyber-threats and risk mitigation steps financial institutions can take including ones concerning ATM cash-out schemes; distributed denial of service attacks; theft of credentials; and destructive malware. Ms. Eberley explained that the FFIEC agencies think it is important for financial institutions to participate in a central place for sharing cyber-threat information and recommended that they join the Financial Services Information Sharing and Analysis Center ("FS-ISAC"). She reported that the FS-ISAC receives cybersecurity information from various intelligence agencies, puts it into actionable form and distributes it to the industry; she observed that the FS-ISAC sends a weekly letter to community bank CEOs describing current cybersecurity issues and has a community banking group. Ms. Eberley noted that the FFIEC Task Force on Supervision has a long-standing information technology subcommittee that is responsible for publishing the IT Handbook. In July 2013, the Task Force also established a cybersecurity and critical infrastructure working group to focus on the cybersecurity threats and how the FFIEC should address them. Ms. Eberley said that the working group undertook a year-long cybersecurity risk assessment that reviewed FFIEC guidance and agency policies and practices and compared those to the standards published by the National Institute for Standards and Technology ("NIST") Cybersecurity Framework and other sources. She said that the review identified parts of the FFIEC Handbooks that needed additional guidance or updating.

Ms. Eberley reported that the FFIEC agencies sent a March 2015 press release that identified seven work streams that the agencies would be pursuing in the following year. The first work stream would be a Cybersecurity Self-Assessment Tool to help institutions evaluate

their inherent cybersecurity risk and their risk management capabilities. She said the tool had been piloted in more than 500 community institutions, that the pilot test gave examiners a base from which to rework the tool, and provided the agencies insight into where additional guidance was needed. Ms. Eberley said that the agencies plan to issue the tool in 2015 as a voluntary self-assessment tool for the industry. Institutions using the tool would first work through a risk assessment matrix to identify the institution's inherent cyber-risk based on its connections to the internet, its operations and how it does business. The second step would be to use the tool to assess the institution's level of preparedness. Ms. Eberley described the five areas covered in the self-assessment: cybersecurity risk management and oversight; how banks gather threat intelligence and collaborate with the industry; cybersecurity controls; external dependency management; and cyber incident management and resilience.

The second work stream Ms. Eberley described was incident analysis, the processes the FFIEC agencies use to gather, analyze, and share information to inform each other during cyber incidents to support a coordinated response. The third work stream was crisis management, or how the FFIEC works with the rest of the government and as part of the public-private partnership to handle cyber crises. Training is the fourth work stream. Ms. Eberley explained that, while the FFIEC agencies ask financial institutions to work with their employees so that they understand good cyber hygiene and how to identify and respond to cyber threats, the agencies are taking similar steps with all their own employees. Ms. Eberley observed that this is not a responsibility that could be assigned only to technology specialists. The fifth work stream she described was policy development, noting that the FFIEC agencies are consulting the NIST Cybersecurity Framework and other sources to fill in any gaps in their IT Handbooks to ensure their scope is comprehensive. Specifically, Ms. Eberley said the FFIEC had released Appendix J to the Business Continuity Handbook which addresses business continuity from a cyber resilience perspective and provides guidance on those issues. The sixth work stream was the examination program for Technology Service Providers ("TSPs"). Ms. Eberley observed that the FFIEC agencies are expanding their focus on TSPs' practices and the examination program for TSPs since so many community banks rely on them for their IT systems. Ms. Eberley noted that TSPs are subject to the same guidance as the banks they service and that the agencies' focus is on the TSPs' interconnectedness and their ability to respond to the growing cyber threats and vulnerabilities. Developing relationships with law enforcement agencies was the seventh work stream. Ms. Eberley said the FFIEC agencies encouraged financial institutions to know in advance who they should contact in case of a cyber incident and said the agencies were similarly building on their existing relationships with law enforcement.

Member Blankenship suggested that the FFIEC consider publishing videos about the Cybersecurity Self-Assessment Tool. Ms. Eberley said that such a video was under consideration. In response to Member Scully's request, Ms. Eberley described how the FDIC ensured that it had staff that was properly trained on cybersecurity issues. She first described the four year examiner commissioning process that includes five formal schools and on-the-job training followed by testing and service as an acting examiner-in-charge. After the commissioning process, Ms. Eberley explained that, since 2010, examiners receive post-commissioning training in four IT schools: basic IT concepts; understanding payment systems; understanding applications; and understanding audit and control in an IT environment. She said about one-third of FDIC's examiners had been through all four schools. Ms. Eberley also

described further training for cadres of examiners to become intermediate subject matter experts and advanced subject matter experts. She said that developing these skills was important and beneficial to the FDIC. Ms. Eberley observed that the FDIC hires some outside expertise in specialized areas such as forensics to supplement its team, but noted that it was simultaneously training examiners who had expressed an interest in the field. Member Scully also asked if the FDIC could describe its conversations with TSPs; she noted that the FDIC's voice could be more important to TSPs than individual banks. Ms. Eberley said that the FDIC has had recent communications with the largest TSPs and anticipated that the FDIC would facilitate collaboration between TSPs and client institutions. She added her view that TSPs are as interested in collaboration as are financial institutions.

Member Hartings said that it would be helpful to community banks to be able to look at a TSP's examination report before the bank entered into a multi-year contract with the TSP. He observed that the current situation (of sharing examination reports only where there was an existing contractual relationship) allowed for the possibility that a bank would engage a TSP based on the TSP's representations only to later find those representations were not supported by the examination. Ms. Eberley observed that TSPs were also interested in providing information to prospective clients and are exploring the creation of information packages that could serve banks' vendor management and due diligence needs. She noted that the issue was complicated because every institution has different vendor management needs, but thought it was worthwhile to explore approaches that served dual purposes. Member Hartings agreed that the basic framework would be helpful and could be supplemented by individual banks to suit their needs. Member Castillo inquired about discussions the FDIC had with TSPs regarding their readiness for cybersecurity attacks. Ms. Eberley said the FDIC examines TSPs the same way as banks are examined and that the FDIC has robust discussions with TSPs about cybersecurity. She observed that even TSPs with the best defenses may still face a cybersecurity problem and must be ready to deal with them. Chairman Gruenberg observed it was fair to say that cybersecurity matters are a work in progress and that, in light of their potential risks, the FDIC was heightening the priority of its TSP examinations and making them an expanded area of attention.

The Committee stood in recess at 12:10 p.m. and reconvened at 1:22 p.m. that same day.

Ms. Ryan introduced Barbara Pacheco, Senior Vice President, Financial Services Division, Federal Reserve Bank of Kansas City, the speaker for the fifth panel, "Recent Developments in the Retail Payment Systems." Ms. Pacheco commented that she had spoken with the Committee in July 2013, a period when the Federal Reserve System staff was developing a consultation paper to obtain feedback on modernizing the U.S. payments system. She reviewed some issues community bankers had raised, including: maintaining the ability to compete with larger financial institutions; community banks' heavy reliance on vendors for technology services; the time and cost of implementing change; payments systems' security issues; and, international payments issues. Ms. Pacheco reported that the Federal Reserve had also consulted about modernization with banks of all sizes, non-banks, technology companies, business users and consumers to develop the paper "*Strategies for Improving the U.S. Payment System*," ("*Strategies*"), published January 26, 2015. She said the Federal Reserve concluded that the payment system needs modernization, a huge undertaking, but one which has broad support for the hard work of further elaborating the plan and implementing it.

Ms. Pacheco described the genesis of the Payments Modernization Strategy. She noted that the reserve banks, in their role as operators of the payments system, regularly update their strategic plan and survey the environment, but also recognized that several factors converged to warrant an expanded end-to-end review of the payments system. These factors included: greater technological capabilities; increased consumer expectations; increased security threats; and international competitiveness issues as other countries upgraded their payment systems. Ms. Pacheco observed that the Federal Reserve issued a modernization consultation paper in 2013 and received over 200 responses which agreed with the goals the Federal Reserve had identified. In addition, the Federal Reserve conducted a series of research studies. One was a global case study on faster, real-time payments systems that researched what business and consumer demand was and their willingness to pay. Ms. Pacheco said the Federal Reserve attempted to identify what types of payments benefited most from speed and reviewed various design options for faster payments. She reported that the Federal Reserve also conducted a payment security landscape study.

Ms. Pacheco observed that the 2015 *Strategies* paper set out five desired outcomes and delineated multi-year actionable deliverables to achieve them. The first goal was speed. Ms. Pacheco observed that checks are ubiquitous, widely accepted, fast once they enter the banking system, and there is no comparable all-electronic alternative that has those characteristics to make payments from one bank account to another. The second goal was security. Here, Ms. Pacheco said, the desired outcome was a very strong payment system, with high public confidence, that was responsive to changing threat landscapes. She remarked that the complexity involved was great and that it was difficult to get all of the many players to adopt common standards and implementing technology that will close the current payment system gaps. The third goal was efficiency. Ms. Pacheco noted that the U.S. payment system still has a large share of payments being made by check, often with a small business on one side of the transaction, and that this provided a good opportunity for improving the system. She said that efficiency would also benefit from having a platform for innovation that could find future efficiencies. Finally, Ms. Pacheco also noted that the efficiency goal takes into account the unbanked or underbanked consumers who currently may not have access to electronic payments. The fourth goal is to increase choice, convenience and timeliness in international payments, attributes which are not present in the current system. Regarding the final goal of collaboration, Ms. Pacheco noted that there are about 6,500 commercial banks, about the same number of credit unions, hundreds of service providers, and millions of businesses. She emphasized that the success of the new payment system design depended on effective coordination among all those groups. Ms. Pacheco said that the website FedPaymentsImprovement.org was established to assist in the collaborative effort and allow virtual forums, presentations, blogs, social media, and two-way conversations among the parties in the payment system.

Ms. Pacheco discussed two issue specific task forces, one focused on faster payments, the other on secure payments. The task forces are chaired by Federal Reserve staff, but will elect participants to assist in managing the work. Ms. Pacheco said that the faster payments task force will identify alternatives for implementing a faster payment system and will address such issues as: what the core infrastructure will be; what features will be included (such as credits, real-time posting, availability, how often settlement happens); what access model will be used to provide

ubiquity of payments to unbanked and underbanked persons; what the cost of implementation will be; and what type of governance and rule structure will be used. The second task force, Ms. Pacheco explained, will focus on the requirements that a faster payment system needs to be secure, safe and resilient. She said the secure payments task force will help set security requirements that the faster payments task force can use to evaluate alternatives. In addition, the secure payments task force would consider how to increase the speed of developing future security standards and how best to share high-quality, actionable cybersecurity data. Ms. Pacheco said that the Federal Reserve could make independent contributions on payments security, including: studying what incentives drive investment (or non-investment) in payment security; providing data collection and data reporting assistance; and facilitating collaboration among the FFIEC and other government agencies to focus on payment security issues.

Ms. Pacheco discussed the strategy for increasing payments efficiency for both domestic and international payments. She said the Federal Reserve studied the possible adoption of a European standard for payments, messages and related information. Ms. Pacheco indicated that the concept of directories was being considered for increasing payments efficiency, as well as increased security and speed. The concept of directories, she explained, meant that a person's bank account information would be kept and protected in the person's financial institution (or a centralized directory) so payment messages could be routed from the payer to the receiver without exposing account information. Ms. Pacheco reported that work is already underway to consider how to implement payment directories securely and efficiently. Ms. Pacheco noted that business-to-business payments remain reliant on check payments and indicated that there is opportunity to achieve greater efficiency as smaller businesses transition to electronic payments. Finally, Ms. Pacheco discussed the strategy to enhance the Federal Reserve Banks' financial services to financial institutions. She said the Federal Reserve had embarked on improving the national settlement service and risk management services for ACH and wire transfers. She concluded that the modernization of the payment system would be a massive undertaking for the industry, but was needed to support continued economic growth and ensure public confidence in the payment system. Ms. Pachecho said that the Federal Reserve had committed its support to the project, but needed private sector engagement, including community banks.

Member Haskin thanked the Federal Reserve for its work. She thought that a "credit push" system using a directory was preferable to a "debit pull" approach because the credit push and directory approach eliminated a significant amount of fraud risk that would exist with debit pull. [The 2015 *Strategies* paper described the credit push methodology as requiring the payer to specify the account number and routing number of the payee in the payment message; in contrast, in a debit-pull payment, the payer supplies his/her account information to the payee.] Member Haskin reported that community banks were concerned that, in a changed payments system, they would have to do multiple daily settlements, but that with a credit push and directory approach, that would not be necessary. Ms. Pacheco anticipated that settlement issues would be a key area for discussion. She said a key element of the discussion would concern how to manage the risk between the fund-sender's financial institution and the fund-receiver's institution in committing to the payment. Ms. Pacheco said directories would be a key aspect of the discussion and observed that decentralized directories could be used as long as they were interoperable in achieving immediate delivery of the payment message. In response to a question from Vice Chairman Hoenig about her vision of the operation of a directory, Member

Haskin said that a customer could register how they wanted to receive their funds, for example, by providing a telephone number or email address. Member Haskin indicated that if the receiving bank had some type of email or memorandum, they could use it as their method of posting funds to the customer's account and then the funds would settle later that night. She thought settlement seems to be a big issue, but that the key was to be sure of having good funds on the credit push side.

Member Hartings asked what Ms. Pacheco viewed as the first step towards standardization; was it a legislative action? Ms. Pacheco reported that the *Strategies* paper encouraged a private sector solution over a regulatory solution. She observed that there is significant fragmentation in payments system innovation and that it would be beneficial if financial institutions could offer real-time payment services that are interoperable with non-financial institutions' services. Member Blankenship expressed concern about the continued role of smaller community banks in payments systems because so many alternatives are available. She said that bankers had heard that other countries had already adopted payments system changes that were working relatively seamlessly and without much fraud or risk, and inquired how difficult it would be to overlay an international model onto the U.S. system. Ms. Pacheco observed that a lot could be learned from international examples and the U.S. did not need to start from zero. She noted that the Federal Reserve's test for a new system included efficiency, ubiquity and security, and that financial institutions' test was the ability to serve their customers in a cost-effective way. Ms. Pacheco said that the collaborative effort would seek a solution that met both the policy and the commercial interest test. Member Castillo suggested it would be a challenge to get all the stakeholders to collaborate; if they did not, the result would be many incompatible systems trying to achieve dominance. Ms. Pacheco agreed and indicated that the goal was to negotiate a common commitment to the ultimate goal as opposed to what benefited a particular business or business segment. In response to a question from Member Busse about coordination between the two task forces, Ms. Pacheco said those issues were being actively considered and that substantial collaboration would be required.

Member Lundy inquired how consumer protection issues weighed in the payments systems modernization project. He observed that chargeback windows were lengthy and could pose a risk to banks in a faster payments environment and inquired what the Federal Reserve thought about the potentially conflicting agendas. Ms. Pacheco said that consumer views were an important perspective to be included in the modernization project. She discussed ways that consumer views could be represented in the task forces, including participation by the CFPB and/or advocacy groups. Ms. Pacheco said the faster payments task force would define the criteria for determining what is an effective faster payments system and that the consumer perspective would be an important element of the criteria. Member Scully expressed concern that alternative lending platforms threatened the viability and relevance of community banks. She noted that credit cards --as opposed to debit cards, checks and ACH-- had become such a viable payment form and observed that credit cards were an area where community banks did not have much presence. Member Scully expressed the view that banks are not making much money off the payment systems while companies such as Apple Pay and PayPal were making money off the front-end of the payment systems. Ms. Pacheco indicated that, although she did not know what the specific revenue generating opportunities would eventually be, she believed that banks would be able to innovate and develop new products off of a modernized payments platform.

She observed that, two years previously, financial institutions did not believe that they would be able to generate enough revenue to offset the cost of upgrading the payments system, but that view had since changed. In response to a question from Chairman Gruenberg, Ms. Pacheco explained that she often used "we" in her comments to express the need for collaboration in the payments modernization project. She noted that the Federal Reserve does not have authority to mandate improvements in the payment system and that the success of the project would require collective effort by financial institutions, non-banks and other stakeholders.

George French, Deputy Director, RMS, Jonathan Miller, Deputy Director, DCP, and Elizabeth Ortiz, Deputy Director, DCP then moderated a panel titled, "Recent Supervisory Updates." Mr. French observed that IRR was an important topic for community banks as the economy transitions from years of low interest rates into a period of rising interest rates. He said the FDIC takes IRR seriously in its examinations and devotes significant effort to increasing IRR awareness and providing technical resources to respond to it. Mr. French said that the recent issue of the FDIC's *Supervisory Insights* journal was devoted to practical advice on IRR for community banks and described four articles on the subject. The first article discussed the fundamental role of corporate governance regarding IRR. Mr. French said that IRR management is not about forecasting interest rates, but ensuring that the bank is prepared for a range of outcomes. The article emphasized the importance of setting limits for items such as net income and economic capital and establishing mitigating steps when those limits are breached. Mr. French observed that the FDIC encourages gradual and prudent rebalancing of a bank's assets and liabilities rather than a rapid, wholesale sell-off of long-term securities. He recognized that mitigating risk by rebalancing involves the sacrifice of current income and observed that examiners would not penalize a bank's CAMELS earnings' rating component if the bank was undertaking a prudent rebalancing strategy. The second article involved developing key assumptions for IRR. Mr. French said the emphasis is to help banks develop and support the assumptions with their existing staff. He noted that examiners would look favorably on simple, conservative assumptions that the bank management understands. The third article dealt with the development by banks of an in-house, independent review of their IRR. Mr. French said the independent review allows a bank board to have a second set of eyes appraising the bank's critical IRR controls to ensure that the controls are working properly. He said there is no requirement that banks engage third parties to perform independent reviews and the article focused on ways banks can use their own resources to conduct them. The fourth article described what banks can expect during an IRR review: items examiners will request to see; the issues they will focus on; the topics they will typically want to discuss with bank management; and, what a bank can do if it disagrees with the examiner.

Mr. French discussed the restrictions on banks that are less than well-capitalized from accepting brokered deposits and the limits on their interest rates for deposits. He observed that, over the years, the FDIC interpreted the statutory restrictions through regulations and in various letters and advisory opinions and recently determined it would be useful to consolidate the material into a single, user-friendly Frequently Asked Questions ("FAQ") format. Mr. French said that the new FAQ document does not establish any new policies. He then emphasized two points about brokered deposits. First, he said, brokered deposits can be a suitable funding source when properly managed as part of a prudent overall funding strategy; FDIC examiners are instructed to look at the totality of a bank's risk profile so that a bank's use of broker deposits

would not result in an automatic examiner criticism. Second, however, Mr. French observed that the overuse of brokered deposits and the improper management of them by problem institutions contributed to bank failures and losses to the Deposit Insurance Fund, and were, in fact, the reasons the statutory restrictions exist. Mr. French said the FAQs describe the meaning of key concepts concerning brokered deposits and provide specific examples of different products. He noted that the FAQs generated helpful discussion with bankers, some of which prompted the FDIC to clarify its meaning; he also said that the FDIC would sponsor an industry teleconference to discuss the FAQ document. Mr. French recognized that many brokered deposit questions depend on specific facts and said that banks that are unsure of the proper treatment could contact their FDIC regional office or headquarters subject matter experts.

Member Lundy spoke about reciprocal deposit relationships such as the Certificate of Deposit Account Registry Service ("CDARS") and the Insured Cash Sweep Program. He indicated that they are beneficial for community banks because they allow certain organizations to make deposits in community banks rather than limiting the placement of those organizations' deposits in banks that are perceived as "too big to fail." Mr. French agreed and observed that FDIC examiners look at the specific situation in assessing risk. He said that in many cases CDARSs may be relationship deposits that pose little risk, while there could be other cases where banks aggressively gather these deposits in a way that increases their risk profile. He also noted that CDARSs meet the statutory definition of brokered deposits. Member Busse said the clarification to the Brokered Deposits FAQ concerning whether insurance agents, lawyers or accountants who refer clients to banks are considered deposit brokers was very helpful.

Mr. Miller described two CFPB proposed rule changes that would affect the application of the CFPB's Ability to Repay / Qualified Mortgage ("ATR/QM") rule (as well as others). The first revision proposed by the CFPB relates to the definition of "small creditor." Mr. Miller noted that the small creditor definition currently has two parts, an "originations" test and a lender "asset-size" test. The current originations test for a small creditor is - if the lender originates 500 or fewer first lien loans. Under the proposed revision, he said, a lender would be a small creditor if it (and its affiliates) sold fewer than 2,000 first-lien loans. Mr. Miller noted that the CFPB proposed no change to the second part of the definition: that the lender must have assets of $2 billion or less (as adjusted for inflation, so that the 2014 asset amount is $2.028 billion in assets). He observed that other QM requirements concerning product restrictions, underwriting requirements, and portfolio holding were also unchanged. Mr. Miller said that, under the CFPB's proposed definition, community banks would be able to make as many portfolio loans as they chose without jeopardizing their small creditor status. He also described the benefits to lenders of having small creditor status. Mr. Miller said the CFPB estimated that the proposed rule change would increase the number of small creditors from 9,700 to 10,400, although he noted that most FDIC supervised institutions already qualified as small creditors.

When the presentation was later opened to Committee questions and comments, Member Hartings observed that there was value to changing the definition of small lender from "500 loans originated" to "2,000 sold" for banks between $500 million and $2 billion in asset size. He said his bank had made 490 such loans in 2012, thus coming close to the current threshold. Mr. Miller agreed that it would not be good policy to discourage banks to stop lending at 499 loans in order to avoid losing its small lender designation. He added that it was even more important that the CFPB's proposed rule changed the focus from the number of loans originated to the number

of loans sold; under the proposed definition, banks would be able to hold an unlimited number of mortgages in their portfolio (if they met the other requirements). Member Hartings also suggested that the CFPB apply its threshold for escrows on higher priced mortgages to the other higher priced mortgage regulations, including appraisals and disclosures.

Mr. Miller also described the CFPB's proposed change in the definition of "rural" for the purposes of the ATR/QM rule, a subject that had been of interest to many community banks. He observed that a rural lender is defined by the location of the loans and mortgages the institution makes, and that, to be rural, more than 50 percent of their loans have to be in a rural area. Mr. Miller described the current CFPB definition of a rural county as including those counties that (during a calendar year) were neither in a metropolitan statistical area ("MSA") nor in a micropolitan statistical area that is adjacent to an MSA. He said the proposed rule change would add an alternate definition of rural to include the situation where the property securing the loans is in an area that is not designated as an "urban area." Mr. Miller said the proposed definition change would be significant: it would increase the number of rural lenders from 2,400 to 4,100 (a number that includes banks and non-banks); and, it would increase the percentage of the population that lives in a rural area from 9 to 22 percent. He also described the benefits of being classified as a small rural creditor.

Ms. Ortiz discussed interagency guidance about encouraging youth savings programs and two related FDIC initiatives focused on expanding youth financial capability. She said the purpose of the interagency guidance was to encourage financial institutions, working with schools, to develop savings programs to improve youth financial awareness and capability. Ms. Ortiz said the guidance was not intended to create any new industry expectations, but rather to clarify how the existing guidelines apply and to compile frequently asked questions and answers. Ms. Ortiz said that many financial institutions collaborated with many schools, government, non-profit and private partners to offer youth savings and financial education programs. She said that there was no single approach to the various programs, but noted that there was consensus that starting early in students' lives helped build good financial habits. Ms. Ortiz said the agencies hoped the guidance would clarify some misconceptions about the application of the rules to programs and thereby encourage new programs and the expansion of existing ones. She then provided the Committee with an overview of the ten FAQs in the guidance, including: the general rules that apply to financial institutions; how they may obtain CRA credit for their programs; customer identification requirements; and when a branch application would be required (or not). Ms. Ortiz said the early feedback from the guidance was positive and the agencies planned to disseminate information about youth savings programs soon. She invited banks to participate in the program and to contact her staff about any questions they might have.

Ms. Ortiz also discussed the FDIC youth saving pilot program that is intended to identify and highlight promising approaches to offering financial education tied to safe, low-cost accounts for students. She said the FDIC launched the program's Phase 1 last August with 9 banks participating and that invitations to participate in Phase 2, involving about 20 banks, would be issued soon. Ms. Ortiz indicated that those joining created a community of participation where banks could learn from each other and receive FDIC technical assistance. In exchange, the FDIC asked participants to share data about their programs, such as: the number of accounts opened; the average amount saved; if the accounts helped the institution establish account relationships with the students' parents; and, what financial education strategy was used.

Ms. Ortiz also discussed the FDIC's Money Smart program for young people which, she said, was completely updated and expanded to cover all grade levels. She noted that the program included companion parent guides that allowed parents to follow what the students were learning in school and that the FDIC also provided videos of selected exercises being taught in classrooms, along with suggestions of how to adapt exercises for various uses.

Member Lundy asked if the FDIC had looked at other educational sources when it revised its Money Smart curriculum and how the FDIC program compared to others. Ms. Ortiz reported that the FDIC development contractor was familiar with other educational offerings. She said the FDIC curriculum was distinguished by its comprehensiveness (covering all age ranges with segments that are targeted and age-appropriate) and by its companion parent guide which included exercises parents could engage in with their children. Member Haskin asked if the Money Smart program for young people taught about the stock market. Ms. Ortiz responded that the Money Smart program for young ages focused on understanding money and basic financial concepts, then banks and banking relationships. She said the high school curriculum was extensive and discussed federally insured investment options such as bank accounts and non-FDIC insured investment vehicles, the relationship between risk and return, and market fluctuation and the potential for loss.

Member Haskin expressed the opinion that youth financial education was particularly important because young people will be responsible for their financial well-being in an environment that does not generally include pension plans. She also emphasized that youth financial education should include information about student loan debt. Member Haskin said her bank was seeing financial statements of young people who had such significant student debt that they would be precluded from borrowing money to purchase a home. She indicated that it is easy for young people to incur student debt without understanding how difficult it can be to repay it. Member Blankenship asked if there was a Money Smart program aimed at small business entrepreneurs. Ms. Ortiz responded that there was a Money Smart for Small Business geared toward emerging entrepreneurs which provides them with the information they need to approach a bank, discuss their business and access capital for their business. She added that the Money Smart programs are usually intended to be delivered by an instructor and so are not available as videos. Ms. Ortiz said that the FDIC partnered with the Small Business Administration and other networks of small business development centers to deliver the Money Smart for Small Business training.

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

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

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

April 2, 2015

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

Board Room

Washington, D.C.

Open to Public Observation

April 2, 2015 — 9:00 A.M.

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

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