

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

November 5, 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: 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 W. Emmons, President and CEO, Gorham Savings Bank, Gorham, Maine; Jack Hartings, President and CEO, The Peoples Bank Co., Coldwater, Ohio; Jane Haskin, President and CEO, First Bethany Bancorp., Inc., Bethany, Oklahoma; James Lundy, CEO, Western Alliance Bank, Phoenix, Arizona; Arvind Menon, President and CEO, Meadows Bank, Las Vegas, Nevada; Mary Ann Scully, Chairperson, President and CEO, Howard Bank, Ellicott City, Maryland; 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.

Cynthia L. Blankenship, Vice Chairman and Chief Operating Officer, Bank of the West, Grapevine, Texas; Mark Hesser, President, Pinnacle Bank, Lincoln, Nebraska; and David Seleski, President, CEO and Director, Stonegate Bank, Fort Lauderdale, Florida, were absent from the meeting.

Corporation staff who attended the meeting included: Ruth R. Amberg, Steven O. App, Bobby R. Bean, Richard A. Brown, John P. Conneely, Joni Creamean, Carolyn D. Curran, Christine Davis, Nancy DelCastillo, Kareem T. Dorsey, Doreen R. Eberley, Diane L. Ellis, Lisa K. Ennis, Sarah E. Faust, Jeffrey S. Follis, George E. French, Janet R. Gordan, Shannon N. Greco, Matthew Green, Robert D. Harris, Craig R. Jarvill, Penny B. King, Geneva B. Kropper, Michael E. McGarvey, Roberta K. McInerney, Jonathan N. Miller, Rae-Ann Miller, Robert W. Mooney, Mark S. Moylan, Christopher J. Newbury, Richard Osterman, Mark E. Pearce, David

W. Riley, Claude A. Rollin, Barbara A. Ryan, Robert F. Storch, James C. Watkins, 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 was also present at the meeting.

Chairman Gruenberg opened the meeting by welcoming the Committee members and participants. He then provided an overview of the meeting agenda, advising that the first panel of the morning session would provide an update on the FDIC's Community Banking Initiative and discuss some recent research projects of the FDIC's Division of Insurance and Research ("DIR"), including additional research on closely held banks; that the next panel would be a presentation from officials from the Financial Crimes Enforcement Network ("FinCEN") on how they utilize the suspicious activity reports and currency transactions reports; and that the next panel would be a presentation from DIR on deposit insurance assessment issues; and that the morning session would finish with a presentation from the FDIC's Division of Risk Management Supervision ("RMS") on emerging trends and risks in the industry, focusing on the FDIC's supervisory examinations. He then advised that the afternoon session would begin with an update on the consumer protection and compliance rules; that the next panel would present an update on the Economic Growth and Regulatory Paperwork Reduction Act ("EGRPRA") review process; and that the last panel would provide an update on the FDIC's cybersecurity initiatives and programs. Chairman Gruenberg then introduced Barbara A. Ryan, Chief of Staff and Deputy to the Chairman and Chief Operating Officer, who would be the moderator for the day's proceedings.

Ms. Ryan introduced the panelists for the first discussion on the FDIC's Community Banking Initiative: Doreen R. Eberley, Director, RMS, Mark E. Pearce, Director, Division of Depositor and Consumer Protection ("DCP"), Diane Ellis, Director, DIR, and Richard A. Brown, Associate Director and Chief Economist, DIR.

Ms. Eberley began with an overview of three areas that RMS was pursuing as part of the Community Bank Initiative: (1) review and revision of the pre-examination request list items; (2) new and updated technical assistance videos; and (3) practical guidance materials for bank directors. With respect to the work initiated in 2012 by RMS on reducing the list of pre-examination request items, she explained that the process for generating a request list has been automated with a program, called "ePREP," that requires the examiner to physically select request list items to ensure that the examiner takes into account an institution's business lines and generates a list tailored to the institution; and that RMS distributes feedback forms after an examination, which have been used to assess the success of this effort. She noted that the scores for whether or not an examiner has been using the information requested have consistently increased since the implementation of ePREP; that, in an effort to streamline the process even further, RMS involved its Field Supervisor Council—a group of representatives from each supervisory region that meet on a quarterly basis—which surveyed all field supervisors, conducted tabletop exercises at training sessions, and developed a description of best practices for immediate implementation, as well as longer term recommendations to enhance the software program; and that the best practices were pushed out to examiners this summer. Regarding the technical assistance videos, Ms. Eberley explained that RMS was updating the Interest Rate Risk

Directors' College video and the Technical Assistance Video to include an expanded discussion on deposit assumptions, which were expected to become more important as interest rates rise; that the updated videos would be published in the Directors' Resource Center in November 2015, together with a Financial Institution Letter ("FIL") to alert bankers about the update; that a new video on cybersecurity awareness would be added to the Directors' College series in November 2015, along with three new vignettes under the FDIC's cyber challenge exercise for community banks depicting three new scenarios that address operational risks; and that two other videos were expected to be available by the end of 2015: (1) an update to the Corporate Governance Directors' College video to incorporate a discussion of strategic planning and an institution's risk profile, and (2) a vendor management technical assistance video. Finally, with respect to the practical guidance materials for bank directors, Ms. Eberley noted that an article on strategic planning in the current earnings environment was released in the FDIC's summer issue of *Supervisory Insights*, and that RMS was developing a directors' handbook, which would be a practical guide for directors that would supplement and expand the guidance in the FDIC's *Pocket Guide for Directors*.

Next, Mr. Pearce provided an update on the consumer compliance technical assistance videos, noting that the FDIC's earlier videos on flood insurance and the ability-to-repay rules were targeted to how they may affect community banks; that, since the release of those earlier videos, there have been updates in the regulatory environment, including a final rule on flood insurance affecting escrow and force-placed insurance and an update to the ability-to-repay rule; and that the FDIC expected to release updates of both of the videos by early 2016. He also noted that, as the FDIC has developed these videos, it has learned that the videos need to be updated as the regulatory environment changes or issues evolve to ensure they remain relevant to community banks. He briefly discussed the surveys conducted with community banks to determine the efficacy of the technical assistance videos and whether they were aware of the program. He explained that almost 800 banks under \$1 billion in total assets from throughout the FDIC's supervisory regions were surveyed during the past summer; that the preliminary results from the 201 responses received indicate that approximately two-thirds—or 68 percent—of the banks were aware of the availability of the video program, with 80 percent of the banks between \$250 million and \$1 billion in total assets being aware of the program but only 55 percent of banks below \$100 million in total assets being aware of the program; that the most common ways in which banks learn of the program are through press releases, the Directors' College, interactions with examiners, and from the FDIC's website; and that, among those banks that were aware of the videos, 90 percent had at least one bank employee who utilized the videos.

Ms. Ellis then provided an overview of the FDIC's ongoing community bank research projects, noting that, since the FDIC's comprehensive study in 2012, it has issued ten community bank studies on topics such as consolidation, rural depopulation, branches, and small business lending; that three studies currently were in development on mutual institutions, economies of scale in community banking, and structural profitability of community banks; and that a section on community banking has been added to the FDIC's *Quarterly Banking Profile*, which has served as a visible score card monitoring of the condition of the U.S. banking industry for over 25 years. She explained that, over the years, a few banks have come to be a dominant share of the assets of the industry, and the community banking section would provide an opportunity to

monitor some of the general trends for the remaining institutions in the industry; and that, for purposes of the FDIC's research, the term "community bank" was not defined strictly in terms of asset size but in terms of the way they do business as relationship lenders relying on core deposits in a limited geographic area. Continuing with some results from the second quarter 2015 community bank quarterly banking profile, Ms. Ellis reported that community banks earned an annualized after-tax return on assets of 0.99 percent, compared to an average of 1.06 for the industry; that approximately 5.3 percent of community banks were unprofitable during the first half of 2015, compared to about 5 percent for the industry as a whole; that year-over-year loan growth was stronger for community banks at 8.8 percent versus 4.8 percent for the industry as a whole; that noncurrent loans were lower for community banks at 1.24 percent, compared to 1.69 for the industry as a whole—which was more pronounced for one-to-four family mortgage loans at 1.59 percent for community banks versus 4.74 percent for the industry as a whole; and that community banks had net interest margins of 3.56 percent for the first half of 2015, compared to 3.05 percent for the industry as a whole.

Mr. Brown then provided additional detail regarding the FDIC's study on closely held banks. He explained that, as reported at the Committee's last meeting, a short examiner survey was developed to gather information on closely held banks relating to ownership structure, overlap between management and ownership, and management succession; and that the survey covered FDIC-supervised banks in the Kansas City, Chicago, and Dallas regions examined in 2014 and early 2015—of which 75 percent were identified as closely held institutions, based on a determination that there was an identifiable primary owner or ownership group that exerts influence over the governance of the institution. He recalled that, based on whether the key officer who runs the bank on a day-to-day basis was a member of, or otherwise affiliated with, the ownership group, the study found that 58 percent of the closely held banks had overlap between ownership and management; that approximately one-half of both the closely held and widely held community banks had not identified a viable successor; and that closely held institutions were considered less likely to be able to recruit management talent from outside the bank. Noting that the FDIC's study showed that—based on return on assets, return on equity, and efficiency ratio—closely held institutions have outperformed widely held institutions consistently over the past five years, Mr. Brown explained that the FDIC further examined the relationship between ownership and management of closely held institutions, specifically how the ownership structure and the overlap of ownership and control might affect their operational efficiency. With respect to how closely held ownership itself might affect operational efficiency, he explained that the FDIC's research showed mixed results; that, theoretically, closely held banks may be less beholden to short term earnings pressures of the capital markets, which allowed them to take a longer strategic view that may be an advantage for long term financial performance; that closely held banks also have the advantage of investing more in monitoring their managers because they capture most of the returns; and that, on the other hand, closely held banks could have some operational disadvantages, including less access to external capital and the possibility that they could pursue goals other than profit maximization. He continued, explaining that the research also showed mixed results with respect to how the overlap of ownership and control could affect operational efficiency; that the alignment of incentives between owners and managers may be a significant advantage for operational efficiency that helps maximize the institution's long term value; and that the overlap of ownership and control could introduce difficulties in succession, as the bank could be looking for its next management

team from a smaller pool of individuals and may need to transfer ownership and management at the same time. Mr. Brown concluded by noting that, in the five years post-crisis, the closely held banks with overlap between ownership and management outperformed the other banks; and that the widely held institutions and closely held institutions where there was no overlap performed at a lower level, indicating that the overlap of ownership and management would appear to be an advantage in terms of the operational efficiency of the institution. He added that examining how management succession may influence these institutions going forward would be a research topic for future consideration.

Member Emmons began the discussion that followed by asking if there was any sampling of mutual banks in the FDIC's research to determine whether their behavior would align them more with closely held institutions rather than widely held institutions. In response, Mr. Brown noted that, geographically, mutual banks would be a different group than the institutions sampled by the FDIC in the middle of the country, which generally had very old charters—43 percent of the closely held institutions sampled had charters more than 100 years old; that mutual banks also were likely to have old charters, but generally were located in the Northeast and throughout Pennsylvania and Ohio; that mutual banks were similar to closely held institutions from a governance standpoint; and that mutual banks were less beholden to capital markets and, in terms of ownership, generally did not have a widely dispersed ownership group. Responding to a question from Member Tolomer about the typical asset size of the banks surveyed, Mr. Brown advised that the closely held institutions were about 20 percent smaller than the widely held institutions, with an average asset size for closely held institutions of \$264 million, compared to \$334 million for widely held institutions.

Member Castillo then asked if there was a definition for what constitutes an overlap between ownership and management, and if the research provided any insight regarding what percentage of time the succession problem led to a change in ownership or control, or a change in both. In response, Mr. Brown explained that the study was based on a survey of examiners-in-charge who were familiar with these institutions; that, of the nearly 1,500 community banks surveyed, the key officer was a member of the ownership group in 48 percent of the closely held banks and, in another 10 percent, the key officer was closely affiliated with the ownership group, which indicated that 58 percent of institutions were defined as having overlap between ownership and management; and that, with regard to changes in ownership or control, the FDIC only had a current snapshot of closely held and widely held status and could not determine if past succession problems resulted in more voluntary attrition at closely held institutions than widely held institutions. Member Busse asked what the implications were for risk in institutions with a lack of succession planning, and whether banks in rural communities without succession plans would have outside influences changing their lending practices or influence on their communities' growth and support after an acquisition. In response, Mr. Brown explained that the FDIC examined risk, but found no significant differences in the empirical results in terms of loan-to-assets ratios and some of the standard measures of risk; and that better indices of portfolio risk would need to be developed to accurately determine if lack of succession planning has implications for risk. With respect to the likelihood of changes related to outside influences after an acquisition, Mr. Brown noted that, in two-thirds of the cases where community banks failed or merged voluntarily, the acquirer was another community bank.

Noting that the technical assistance video program was very helpful, Member Lundy suggested specifically reaching out to state institution directors to let them know about the updates to the videos in order to more broadly distribute the information. Ms. Eberley responded by advising that the FDIC has partnered with state associations and communicated with the Conference of State Bank Supervisors in an effort to provide information to all of the state bank commissioners; and that, going forward, it would be a good idea to do something programmatically with the state bank associations since that has not previously been done. Noting that it was important to put information on the updates in the FILs, Member Hartings asked if there was a timetable available for community banking on the current expected credit losses (“CECL”) proposal from the Financial Accounting Standards Board. In response, Ms. Eberley advised that the FDIC would release a technical assistance video on CECL after the proposal became final; that the FDIC would probably hold a teleconference to discuss the model prior to that; and that, since full implementation probably would not occur until 2018, a series of training events could be expected. In response to Member Thompson asking if any changes in the examination process related to succession planning should be expected, Ms. Eberley emphasized that succession planning has always been a component of evaluating management in the examination process, and that was not expected to change. Member Haskin asked if any research had been done on the relationship to capital in the ownership structure, specifically whether there was a greater tendency for a bank owner to put more capital in the institution than non-ownership groups. In response, Mr. Brown explained that capital formation was a very important topic, but difficult to understand in this context; that, from 2009 to 2014, data on the gross capital raised by source indicates that closely held banks had raised 60 percent of capital from retained earnings and 40 percent from external sources, as compared to a 50/50 ratio for widely held banks.

Chairman Gruenberg then noted that the FDIC’s research shined a light on an underappreciated aspect of the community bank structure and suggested that the ownership form was even more broadly utilized than the FDIC may have thought; and that the knowledge on this ownership form was extremely important in helping to understand and monitor the implications for the community banking structure going forward. He also noted that the technical assistance videos were particularly valuable to the smaller institutions, and that the additional outreach efforts suggested by some of the Committee members could increase the level of awareness among smaller institutions of the existence of the FDIC’s video program. He suggested that the FDIC needed to work on outreach in this area, and was particularly grateful for the suggestions from the Committee.

Next, Ms. Ryan recalled that there was some discussion at the last meeting of the Committee about what FinCEN does with the currency transaction reports and the suspicious activity reports. She then introduced Jamal El-Hindi, Deputy Director, FinCEN, and Kris Patel, Senior Advisor, Intelligence & Liaison Divisions, FinCEN, for the panel discussion on the “Financial Crimes Enforcement Network (FinCEN).”

Mr. El-Hindi began by providing a brief overview of FinCEN, explaining that it was a part of the Treasury Department reporting to the Office of Terrorism and Financial Intelligence; that FinCEN served as the financial intelligence unit (“FIU”) for the United States; that its mission was to safeguard the financial system, combat money laundering, and promote national

security; and that these objectives were achieved by collecting, analyzing, and disseminating financial intelligence, as well as by building global cooperation with counterparts in other countries. He explained that the Bank Secrecy Act (“BSA”) required a wide range of U.S. financial institutions to maintain records and file reports with FinCEN; that the reporting contributed critical information that was routinely analyzed by FinCEN, resulting in the identification of suspected criminal activity and the initiation of investigations; and that FinCEN disseminates the information to law enforcement, primarily through the use of a new search tool called “FinCEN Query,” which helped to identify significant relationships, trends, and patterns. He noted that financial institutions dedicate a substantial amount of resources to comply with the BSA requirements; that sometimes there may be frustration and the perception on the part of financial institutions that the information goes unutilized; and that part of that frustration and perception may stem from the fact that FinCEN works with law enforcement to conduct lengthy follow-up investigations that are confidential and take a significant period of time to complete. He explained that FinCEN attempts to provide as much information as possible with respect to how the data submitted by financial institutions was actually used, noting that FinCEN has on its website numerous success stories grouped according to the type of reporting, such as examples of cases where a currency transaction report was instrumental in a law enforcement case. Mr. El-Hindi concluded with a brief discussion of FinCEN’s searching program under section 314(a) of the USA PATRIOT Act, which creates another burden for the industry. Noting that the 314(a) program was based on strict criteria and not used frivolously, he explained that this program allows FinCEN to send out requests to the financial community—primarily the depository institution and securities sectors—for information in situations where law enforcement was particularly interested in financial data that could be used to support a significant money laundering case, and law enforcement has exhausted other methods of obtaining the information; that FinCEN has a rigorous process for creating the requests; and that, in terms of the success of the program, approximately 95 percent of all of requests that FinCEN has made contributed to arrests or indictments.

Ms. Patel then briefly discussed how the collected data was used in combatting terrorist financing. She noted that FinCEN was working on multiple fronts and in tandem with other U.S. government agencies to undermine terrorist groups from traveling to the conflict zone and providing support; that FinCEN has the overriding goal of administering the BSA to ensure the integrity and transparency of the U.S. financial system so that terrorist financing can be prevented and detected for follow on action; and that U.S. financial institutions have had a pivotal role in helping safeguard the integrity of the U.S. financial system by providing the first line of defense to combat terrorist financing. She continued, explaining that the BSA reports provided the U.S. government with valuable insight into financial activities where terrorist groups operate; that, to facilitate this process, FinCEN has employed more than 100 automated business rules or algorithms to screen filings on a daily basis; and that FinCEN analysts would sort through information generated from these rules to identify problems and flag subjects not currently under investigation who exhibit behavior patterns indicative of significant money laundering and terrorist financing-related activities. She concluded by noting that a number of financial institutions with members on the Committee had directly contributed to the development and dissemination of three flash reports related to terrorist groups within the past six months; and that FinCEN, as the FIU of the U.S., was uniquely positioned to facilitate the sharing of information worldwide through the Egmont Group of FIUs.

In the discussion that followed, Committee members offered a number of comments and suggestions. Member Tolomer asked if a balance could be found between fighting terrorism and reducing the reporting burden without compromising the usefulness of the information; Member Scully suggested that there may be ways to improve the efficiency of the process without compromising the value of the information obtained. In response, Mr. El-Hindi explained that there was an exemption process; that financial institutions may not be taking full advantage of that option; and that FinCEN was constantly looking for ways to reduce the burden associated with reporting, particularly the reporting thresholds and aggregation requirements. Commenting that community bankers were risk managers and that often preferred filing the reports rather than filing for exemptions to ensure compliance with the reporting requirements, Member Hartings suggested that FinCEN may find that changing the reporting threshold was more effective. Mr. El-Hindi responded by explaining that a study on the issue of adjusting the threshold from \$10,000 to \$30,000 was done about 10 years ago based on information from the Federal Bureau of Investigation; and that it was concluded that raising the threshold would have resulted in the loss of roughly 40 percent of the information that had been received with respect to particular terrorism related cases. Member Hartings then asked how FinCEN would handle virtual currency that could be used as cash, such as Bitcoin. In response, Mr. El-Hindi explained that there were some challenges with respect to virtual currency, but that transactions that used virtual currency were electronic transmission and generally easier to track because they left more of a record.

Member Lundy asked how FinCEN handles the issues of cybersecurity and fraud, specifically how it coordinates with foreign banks on these issues. In response, Mr. El-Hindi noted that cybersecurity was a very big concern for FinCEN; and that FinCEN has increasingly been able to use its FIU connections around the world to very quickly identify funds and have them returned. Member Haskin added to the discussion on the currency transaction reporting threshold issue, noting that her institution was catching a lot of unintended situations, such as garage sales; that an analysis of their currency transaction reporting found that it would be reduced by two-thirds if the threshold was increased from \$10,000 to \$20,000; and that the current threshold had not been adjusted since approximately the early 1980s. She then asked if FinCEN was monitoring the use of prepaid cards and online lending services. Mr. El-Hindi responded by explaining that FinCEN current monitoring of nondepository institution lending was restricted to residential mortgage lenders; that there may be a category of lenders that was not covered under FinCEN's regulations; and that, while prepaid cards were easy to purchase at retail locations without much information, a user would have to provide more information and go through a verification process to reload a prepaid card for use as more of a credit card than a gift card,.

Ms. Ryan then announced that the meeting would briefly recess. Accordingly, the meeting stood in recess at 10:48 a.m.

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The meeting reconvened at 11:11 a.m. that same day, at which time Ms. Ryan introduced Ms. Ellis, Director, DIR, and Matthew Green, Associate Director, DIR, to present the next panel,

“Deposit Insurance Assessment Issues.” Ms. Ellis began by noting that the FDIC was reviewing the comments received on the recently issued Notice of Proposed Rulemaking to update its Small Bank Deposit Insurance Pricing Method; that the most recent semi-annual update on the FDIC’s Deposit Insurance Restoration Plan (“Restoration Plan”) projected that the Deposit Insurance Fund (“DIF”) was on target to reach the new statutory minimum reserve ratio of 1.35 percent by 2020, as required under the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), with the DIF reserve ratio currently projected to reach 1.15 percent by the first quarter of 2017; and that the FDIC Board of Directors recently approved a Notice of Proposed Rulemaking (“NPR”) with a proposal to reach the statutorily required minimum reserve ratio of 1.35 percent—which would become effective when the reserve ratio reaches 1.15 percent—by charging the largest banks a surcharge (in addition to their regular assessments) to fill the gap in raising the reserve ratio the rest of the way to 1.35 percent.

Mr. Green then discussed the FDIC’s proposal to increase the minimum reserve ratio, noting that the NPR was issued with a 60-day comment period. He advised that the proposal has three key parts which provide that: (1) there would be surcharges on large banks—defined as more than \$10 billion in assets—which would be expected to last for approximately eight quarters and total approximately \$10 billion, with the first \$10 billion of assets being excluded from the surcharges and a gradual increase in surcharges as banks increase in size; (2) to address any potential shortfall issues, if, at the end of 2018, the reserve ratio has not reached 1.35 percent, then a surcharge to close the gap would be issued in the first quarter of 2019; and (3) once the reserve ratio was safely above the minimum target, banks with less than \$10 billion in assets would receive assessment credits for their portion of the assessments that contributed to the growth from 1.15 to 1.35 percent. He explained that great care was taken to balance multiple interests, including: meeting the FDIC’s goal in a reasonably timely manner in order to strengthen the DIF, providing stability and predictability in assessments for all banks, and considering the effects on bank capital levels. Mr. Green concluded by advising that, once the FDIC meets the 1.35 percent ratio, the FDIC would have satisfied the requirement under the Dodd-Frank Act of reaching the minimum reserve ratio of 1.35 percent by September of 2020; and that, if the economy or the industry hits a rough patch—whether it’s in 2019 or 2020—and we have already reached 1.35 percent, the FDIC would have eight years under the DIR Restoration Plan to once again reach a 1.35 percent ratio. Noting that the FDIC would not have to reach the 1.35 percent ratio again by 2020 because it would have already met that goal, he emphasized that, since it was very difficult to predict the future, it was important for the FDIC to avoid being in a situation where it would have to raise the assessment rates on large banks (and potentially on smaller banks) in a few years from now, if the industry found itself in a difficult time.

In the discussion that followed, Member Hartings began by asking for clarification regarding how the growth of the reserve ratio from 1.15 to 1.35 percent would be achieved and how the community banks would receive credits based on their contributions. In response, Mr. Green explained that the growth in the reserve ratio from 1.15 to 1.35 percent would be achieved with both the regular assessments and the surcharges, and, to the degree that small bank assessments were contributing to the increase in the reserve ratio, that credits would be provided based on the contribution made. Member Lundy asked if the risk to the FDIC’s fund had been reevaluated post-crisis, since banks of all sizes have dramatically increased their capital. Ms.

Ellis responded, noting that the analysis had not been updated since a long term plan was put in place, but that it would be an interesting analysis to complete. She further explained that the 1.35 percent fund reserve target was a statutory minimum, and that the FDIC was required to set a reserve ratio every year, which has been set at two percent based on a historical analysis of what would be needed in order to maintain a positive balance.

Ms. Ryan then introduced Ms. Eberley, James C. Watkins, Senior Deputy Director, RMS, and Rae Ann Miller, Associate Director, RMS, to present the next panel, "Risk Management Update: Emerging Trends and Risks." Ms. Eberley began by noting that the panel discussion would first focus on examination trends and growth in various commercial real estate loan categories, followed by a discussion on marketplace lending, which has been an emerging trend.

Mr. Watkins briefly described some initial examination trends, noting that the number of banks on the FDIC's official problem bank list had declined from a peak of 888 institutions in 2011 to 228 institutions at the end of the second quarter of 2015, which was a 74 percent reduction; that other positive trends included increases in net income and loan balances, and declines in past dues and charge offs; and that there was a decline in the number of matters requiring Board of Directors attention cited in examinations, such as management, lending and credit administration, interest rate risk, and information technology issues.

Ms. Miller then briefly discussed the latest commercial real estate trends, noting that the current level of total commercial real estate was nearing historical levels, with most of the dollar volume of growth being driven by the non-farm/non-residential category even though it had a modest year-over-year growth of 4 percent; that the growth in the multi-family residential category has been the strongest, with a year-over-year growth in excess of 11 percent since 2013; and that growth in the construction and land development category has begun to improve from the significant decline during the crisis, with a current year-over-year growth rate of 11 percent even though residential construction was nowhere near the proportion it was before the crisis. She also noted that there were considerable upticks in unfunded amounts in both residential and other types of construction, which could mean more growth in this segment moving forward. Ms. Miller then discussed marketplace lending, noting that the U.S. Treasury Department had recently issued a request for comment on marketplace lending, receiving over 100 comments; that marketplace lending was essentially the creation of online platforms that connect borrowers with lenders, typically bypassing traditional loan providers; that the earliest type of this lending was called peer-to-peer lending, led by two companies that provided online lending platforms; and that, as marketplace lending has evolved, there has been less reliance on individuals, with most of the funding now being provided by institutional-type investors. She emphasized that the FDIC was monitoring this trend for the effect on FDIC-regulated institutions, and would be interested to hear if Committee members were aware of any emerging risks in this area.

In the discussion that followed, Committee members offered a number of comments and suggestions. Member Bryant asked how these institutional investors were being regulated, noting potential concerns about consumer protection. In response, Ms. Miller explained that the institutional investors in marketplace lending typically were hedge funds or venture capital firms, as well as some banks; that the regulator would depend on the particular type of investor; and that many of the concerns raised in the comments received by the U.S. Treasury Department

were along the same path, discussing regulation and consumer protection concerns. Mr. Watkins added that, because there was such a wide variety of funding sources, it was unclear how stable these sources would be in a time of stress. Member Bryant then asked if the FDIC had demographic profiles on the borrowers involved in marketplace lending. Ms. Miller responded, explaining that the data available was from the individual companies themselves; and that these companies generally report that the preponderance of the loans they were making were to borrowers with top level credit quality. Member Haskin also voiced consumer protection concerns, particularly in regard to small business lending, suggesting that it would be easy for a borrower to get caught up in a never ending borrowing cycle to meet cash flow shortfalls; Member Busse added that borrowers may not realize the implications of automatic withdrawals that were typical in these situations. In response, Ms. Miller agreed, noting that because small business loans do not require the same kind of disclosures as consumer loans, this could become an issue.

Member Scully commented that it would be difficult for the FDIC to directly address these issues because the institutions typically involved in marketplace lending were not depository institutions. Member Castillo commented that, because local businesses and borrowers were utilizing these platforms, there must be a gap in terms of what community banks were offering. He suggested that innovation in the community bank space could turn marketplace lending concerns into an opportunity, depending on what the regulatory response to such innovation might be. In response, Mr. Watkins noted that community banks generally were doing a good job lending to small businesses; and that the FDIC would work with banks on innovative ideas to ensure that their products retained safety and soundness attributes. Member Williams expressed the concern that, because credit quality was improving and rates were coming down, marketplace lending would become a competitive concern for community banks. Member Busse commented that these types of companies do not know their clients and could lend in situations that potentially impact community businesses and create systemic risk.

Chairman Gruenberg thanked the Committee members for their contributions to the discussion, noting that it had been helpful, and that the FDIC would be paying close attention to both the general risk created by marketplace lending, as well as the impact it may have on FDIC-regulated institutions.

Ms. Ryan then announced that the meeting would break for lunch. Accordingly, at 11:59 a.m., the meeting stood in recess.

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The meeting reconvened at 1:15 p.m. that same day, at which time Jonathan N. Miller, Deputy Director, Policy and Research, DCP, began the next panel discussion, "Update on Consumer Protection and Compliance Rules." Mr. Miller provided a brief update on the new Home Mortgage Disclosure Act ("HMDA") reporting rule, explaining that it would be phased in in two parts; that, beginning in 2017, there would be a new higher loan volume threshold for depository institutions that would decrease the number of HMDA reporters; and that, in 2018, the number of reporting categories would increase and HMDA reporters would need to begin reporting for the categories where they exceed the threshold. He also explained that in

coordination with the new requirements, the Consumer Financial Protection Bureau (“CFPB”) planned to streamline the reporting by requiring a correct submission the first time, eliminating the need for resubmissions. In regards to the impact of the ability-to-repay and qualified mortgage rule (“ATR/QM Rule”) on mortgage lending, Mr. Miller noted that the FDIC’s research, using the 2014 HDMA data, found no measurable effects on mortgage lending; that the volume of mortgage originations appeared to be unaffected by the ATR/QM Rule; that the ATR/QM Rule has not led to a substantial decrease in the number of institutions participating in the mortgage market, even among small community bank lenders; and that the ATR/QM Rule was not associated with a disproportionate decline in low and moderate income, or minority loan shares. He then discussed some changes made by the CFPB to its small creditor and rural areas rule, explaining that the new rule expanded the definition for small creditor by increasing the threshold, effectively moving nearly all of the FDIC-supervised institutions into this category; and that the definition of “rural” was clarified to include any census block not deemed by the U.S. Census Bureau to be urban. Mr. Miller concluded with a brief discussion of the new TILA-RESPA Integrated Disclosures rule (“TRID Rule”) that recently went into effect, explaining that the FDIC’s focus would be on ensuring that banks were taking concrete steps toward implementation of the TRID Rule by training staff and planning for full implementation; and that the FDIC’s examiners have been instructed to make sure that institutions were making good faith efforts toward compliance.

In the discussion that followed, Member Williams asked if, under the expanded scope of coverage in the new HMDA rule, home improvement loans that are not secured by the dwelling would still need to be reported, as they were under the old rule. In response, Mr. Miller advised that home improvement loans secured by the dwelling were covered and need to be reported, but was unsure if home improvement loans not secured by the dwelling were covered under the new rule, and that he would need to check into that possible exception and respond at a later date. Noting that under the old HMDA reporting requirements the difference between owner occupied mortgage lending and investment property mortgage lending did not need to be reflected, Member Haskin asked if that had changed under the new requirements. Mr. Miller noted that he planned to check on that and respond at a later date.

Noting the expanded HMDA fields, Member Castillo asked whether there were concerns, that an individual’s privacy would be impacted. Mr. Miller responded affirmatively, explaining that there was a version of the HDMA that the public sees, and a more complete version of the data that was available to the regulators. In response to a question from Member Scully about the possibility of the HMDA data fields changing, Mr. Miller stated that it was unlikely in the near future since they had not yet been implemented. Member Hartings commented that managing the three day disclosure requirement prior to closing was a difficulty with TRID compliance; that this could delay closings and complicate escrow estimates; and that his institution used to obtain a 30-day commitment, but has had to increase it to a 45-day commitment, which results in customers paying higher rates. In response, Mr. Miller emphasized that a good faith effort to comply with the rule was what examiners would be looking for, and that a delay in closing would only be required when there is a major change in the loan estimate. Member Hartings also commented on vendor management, suggesting that it would be helpful if regulators put pressure on third party vendors to cooperate with community

banks in complying with the requirements, in order to reduce the burden on community banks in monitoring these vendors.

Ms. Ryan then introduced Roberta K. McInerney, Deputy General Counsel, Legal Division, Ruth R. Amberg, Assistant General Counsel, Legal Division, and Mr. Watkins for the next panel, “Update on the FDIC’s Regulatory Review under the Economic Growth and Regulatory Paperwork Reduction Act (“EGRPRA”),” which would provide an overview of some of the general themes that have been discussed at the EGRPRA meetings. Ms. McInerney recalled that EGRPRA requires the banking agencies to review their regulations at least once every ten years to identify any outdated or otherwise unnecessary regulations; that the FDIC’s last review was completed in 2006; and that the current review process underway would be completed by 2016. She noted that, as part of the formal outreach process, the FDIC had divided the regulations into categories and has published three of four planned notices in the *Federal Register* seeking public comment on several categories of regulations identified in each notice; that the fourth and final of these notices would be published in the *Federal Register* by the end of 2015, seeking comment on regulations in the categories of rules of procedure, safety and soundness, and securities. She added that the agencies decided to expand the scope of the EGRPRA review to include newly issued rules, including those issued under the Dodd-Frank Act; that the final Federal Register notice would specifically solicit comments on any regulations not specifically included before; and that the FDIC was open to receiving comment on any regulatory topic that a commenter wanted to raise. She briefly explained that, in response to the first three notices, the FDIC had received 80 comments, which are currently being reviewed; that after the comments were reviewed, a report would be prepared on whether certain regulatory elements can be amended or eliminated; and that, as part of the EGRPRA review, the FDIC was holding six outreach sessions across the country, seeking direct input from bankers.

Mr. Watkins reported that five recurring themes have emerged from the comments and outreach sessions of the EGRPRA process: (1) Call Reports; (2) examination frequency; (3) appraisal thresholds; (4) Bank Secrecy Act (“BSA”) requirements; and (5) communication in the examination process. He explained that bankers expressed a desire for streamlined Call Reports, particularly for community banks; that the agencies had recently issued a notice proposing burden reducing changes in the Call Reports; and that the FDIC was exploring the feasibility of a community bank call report. Additionally, he noted that many bankers were seeking fewer examinations and an adjustment of the examination frequency requirements, including raising the exemption threshold; that many bankers suggested raising the appraisal threshold; that many commenters suggested raising the Bank Secrecy Act threshold and recordkeeping requirements, as well as allowing more exemptions from reporting; and that a number of banks suggested improvements to communication during the examination process, such as maintaining open and regular lines of communication to ensure that supervisory expectations intended for the largest banks are not applied to community banks. Finally, he mentioned some additional comments that were raised at the Chicago outreach meeting, with commenters suggesting possible changes to the Community Reinvestment Act (“CRA”) requirements, including amending the asset size designation for CRA examinations and possibly assigning CRA designations by market or business model instead of asset size. In regards to flood insurance, commenters expressed concern over the determination of whether or not a property was located in a flood zone, and

expressed the need for enhanced communication between the National Flood Insurance Program, bankers, and local Government agencies.

Member Castillo opened the discussion following the panel's presentation, asking if the field visits to evaluate the manual component of the Call Report had been instructive. In response, Mr. Watkins explained that a working group was currently looking at ways to further streamline the Call Report process; that an initial finding was that there were a number of fields which did not generate helpful information; and that there was room to potentially simplify the process.

Ms. Ryan then introduced Ms. Eberley and Mark Moylan, Deputy Director, Operational Risk, RMS, for the final panel, "Update on Cyber Security." Mr. Moylan began the presentation by reminding the Committee of the new cybersecurity assessment tool released by the Federal Financial Institutions Examination Council ("FFIEC") and that, in coordination with this effort to better combat cybersecurity risk, the FDIC has conducted industry outreach events and internal training, and revisited the community bank examination program. He explained that the primary areas of focus include an information security program that defines a bank's ability to detect, respond, and restore operations if a cyber event occurs; that cybersecurity was a business risk that warranted the understanding and involvement of the board of directors; and that the focus on cybersecurity needed to move from the server room to the boardroom to ensure that information security was included as part of the institution's risk management program. In an effort to elevate the dialogue and awareness regarding cybersecurity, Mr. Moylan noted that the FDIC has conducted banker cyber awareness events in its regional offices over the past summer; prepared a director's video on cyber awareness as part of the FDIC's technical assistance video program, released three new Cyber Challenge video vignettes—guided exercises for banks to walk through various business disruption scenarios, prepared a vendor management video for release, held a national call with FDIC supervised banks about cybersecurity, and conducted staff training sessions on cybersecurity. He also noted that the cyber awareness events in the region discussed a number of topics, including: the evolution of data security; how to define cybersecurity, cyber risk, and the threat environment; information security program enhancements; and the FFIEC's newly released cyber assessment tool.

Mr. Moylan next provided an update on the FDIC's community bank Information Technology Work Program Revision Project ("ITRMP"), explaining that the project began in late July and was designed to better identify and assess information technology ("IT") risks at community banks; and that pre-examination activities have been materially changed in the revised program by forwarding a list of questions related to IT security to the bank, which would allow bank staff more time to accurately answer the questions and the FDIC examiners the opportunity to more effectively risk scope an examination commensurate with the bank's IT. He advised that the revised information technology work program has been completed and was currently under review by management; and that, after approval of the revised program, the FDIC planned to conduct a pilot test program in selected offices around the country through the first quarter of 2016, with implementation around mid-2016. In conclusion, Mr. Moylan noted that the FDIC also was currently working with other FFIEC agencies to update and revise all FFIEC IT examination handbooks to address cybersecurity.

In the discussion that followed, several Committee members commented on the usefulness of the cyber assessment tool and the FDIC's complimentary efforts to increase cybersecurity awareness. Member Hartings asked if anyone had seen how the cyber assessment tool worked for community banks. In response, Mr. Moylan noted that it was a voluntary tool not necessarily being utilized by everyone, but that he had heard it took anywhere from 80 to 200 hours to complete. He emphasized that although he was not technically savvy in this area, but expected IT professionals to be able to explain why certain elements were important from an IT perspective; and that bank board members can ask similar questions of their experts.

Chairman Gruenberg then asked Mr. Moylan to briefly discuss how the technology service provider relationship factors into cybersecurity concerns. Mr. Moylan explained that threat intelligence was a hot topic, and that the FDIC expects institutions to have a threat intelligence program, through the use of external resources. He encouraged a collaborative type of effort between the community banks and their service providers, noting that community banks cannot entirely rely on service providers but needed to be involved in the process. He referred Committee Members to Appendix J of the business continuity handbook under the FFIEC IT handbook, which thoroughly assesses issues involved in third party vendor management. Chairman Gruenberg then noted that the cybersecurity effort was a work in progress, and that he expected the discussion to continue. He noted that it would be incredibly helpful to receive feedback from Committee members as they utilize the tools, and that third party vendor management was indeed an issue of concern that would continue to be evaluated.

In bringing the meeting to a close, Chairman Gruenberg emphasized that it was an excellent meeting, and that he would welcome any feedback from Committee members on issues they may like to include on the next meeting agenda. He then mentioned the Bank On initiative in a number of cities around the country to expand access to the banking system for those who are either unbanked or underbanked, explaining that BankOn brought together local partnerships of financial institutions and local government officials, as well as community organizations; that Bank On recently introduced a set of national account standards to provide these individuals with a full range of account services at a lower cost; and that a number of large institutions offering a product consistent with those standards were finding that it appealed to the unbanked and underbanked, as well as existing customers. Chairman Gruenberg concluded with the suggestion that the Committee may want to consider having a presentation with an overview of the BankOn effort at its next meeting.

There being no further business, the meeting was adjourned at 2:31 p.m.



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

November 5, 2015

Minutes
of the
Meeting of the FDIC Advisory Committee on Community Banking
of the
Federal Deposit Insurance Corporation
Held in the Board Room
Federal Deposit Insurance Corporation Building
Washington, D.C.
Open to Public Observation
November 5, 2015 – 9:00 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

