FEDERAL DEPOSIT INSURANCE CORPORATION

ADVISORY COMMITTEE ON COMMUNITY BANKING

MEETING

WEDNESDAY
JULY 20, 2015

The Advisory Committee met in the Board Room of the FDIC Headquarters, 550 17th Street, N.W., Washington, D.C., at 9:05 a.m., Martin J. Gruenberg, Chairman, presiding.

PRESENT

MARTIN J. GRUENBERG, Chairman, FDIC
CYNTHIA L. BLANKENSHIP, Bank of the West
PEDRO A. BRYANT, Metro Bank
LEONEL CASTILLO, American Bank of Commerce
CHRISTOPHER W. EMMONS, Gorham Savings Bank
JANE HASKIN, First Bethany & Trust
JAMES LUNDY, Western Alliance Bank
MARY ANN SCULLY, Howard Bank
DAVID SELESKI, Stonegate Bank
GWEN M. THOMPSON, Clover Community Bank
JOHN M. TOLOMER, The Westchester Bank
DEREK B. WILLIAMS, Century Bank & Trust
PANELISTS PRESENT

BARBARA RYAN, Chief of Staff, FDIC
RUTH R. AMBERG, Assistant General Counsel, Legal Division, FDIC
FRANK M. BLANCHARD, Economic Analyst, Division of Insurance and Research, FDIC
LUKE H. BROWN, Associate Director, Division of Depositor and Consumer Protection, FDIC
DOREEN R. EBERLEY, Director, Division of Risk Management Supervision, FDIC
KATIE L. KRAMER, Economic Assistant, Division of Insurance and Research, FDIC
GREG A. LYONS, Student Trainee, Division of Depositor and Consumer Protection, FDIC
ROBERTA K. McINERNEY, Deputy General Counsel, Legal Division, FDIC
JONATHAN N. MILLER, Deputy Director, Division of Depositor and Consumer Protection
RAE-ANN MILLER, Associate Director, Division of Risk Management Supervision
MICHAEL S. McCOY, Student Trainee, Division of Risk Management Supervision, FDIC
MARK S. MOYLAN, Deputy Director, Division of Risk Management Supervision, FDIC
FAYE MURPHY, Section Chief, Division of Depositor and Consumer Protection, FDIC
MARK PEARCE, Director, Division of Depositor and Consumer Protection, FDIC
STEPHEN H. SIMPSON, Senior Financial Analyst, Division of Insurance and Research, FDIC
ROBERT F. STORCH, Chief Accountant, Division of Risk Management Supervision, FDIC
JAMES C. WATKINS, Senior Deputy Director, Division of Risk Management Supervision, FDIC
C-O-N-T-E-N-T-S

Introductory Remarks ........................................... 4
CBI Update and Follow Up from Community .......... 10
Banking Conference

Millennials' Perspectives on Banking ............ 30

Update on the FDIC's Regulatory Review ....... 90
under the Economic Growth and Regulatory
Paperwork Reduction Act (EGRPRA)

Update on Consumer Compliance Issues ........ 103

Fintech Discussion ............................... 135

Recent Supervisory Developments ............. 181

Closing Remarks .......................................... 222
(9:05 a.m.)

CHAIRMAN GRUENBERG: Welcome, everybody. I'd like to welcome you all to this meeting of our advisory committee.

Before I walk through the agenda, I wanted to start by acknowledging and thanking a number of our advisory committee members who, sadly, are here for their last meeting because their terms on the advisory committee are coming to an end.

We established two-year terms, but we really didn't want to let people go, if we could, so we actually extended them and each of the people who are now leaving actually had agreed to serve on extensions of their two-year terms. As a general rule, we try to rotate membership to give as many bankers as possible an opportunity to serve on the committee.

If I may, I'd like to just acknowledge at the outset, the following committee members for whom this will be their last meeting: Cynthia
Blankenship, Vice Chairman and CFO of Bank of the West, Grapevine, Texas; Pedro Bryant, President and CEO, Metro Bank of Louisville, Kentucky; Lionel Castillo, President and CEO of American Bank of Commerce, Provo, Utah; Jane Haskin, President and CEO, First Bethany Bank Corp, Bethany, Oklahoma; Mark Hesser, President, Pinnacle Bank, Lincoln -- excuse me -- Lincoln, Nebraska; James Lundy, Chief Executive Officer, Western Alliance Bank, Phoenix, Arizona; David Seleski, President, CEO, and Director of Stonegate Bank in Fort Lauderdale, Florida; and Derek Williams, President and CEO of First People's Bank, Pine Mountain, Georgia.

Let me just express my personal gratitude. It's been a pleasure getting to know each of you. I think each of you has really made terrific contributions to this committee and genuinely enhanced the FDIC's appreciation of the -- I guess of the challenges and opportunities facing community banks.

We're grateful for the opportunity -- that we've had the opportunity of
getting to know you, and we thank you very much for your service to this agency.

PARTICIPANT: Thank you.

PARTICIPANT: It's been a great experience.

CHAIRMAN GRUENBERG: Let me, if I may, give you a brief overview of the agenda for today's meeting, which is pretty full, and I think will be of interest.

The first session today will provide an update on the FDIC's Community Banking Initiative and a report on some follow-up items from our community banking conference, which took place in April of this year.

Second, you may recall that at our community banking conference in April, and also at the most recent meeting of this committee, there was some interest expressed in seeing if we could get a better understanding of the perspectives of millennials on banking. So we've tried to round up a few --

(Laughter.)
CHAIRMAN GRUENBERG: -- and asking about their banking needs, communication styles, and expectations, as well as how they use technology to conduct banking transactions. In addition, there was some interest in discussing the best ways for banks to recruit and retain employees from the millennial generation.

As I indicated, we've asked a few of our millennial employees to make a presentation to the committee today. That will begin at 9:30. I think you'll find them interesting. I actually had the chance to meet with them and some of our senior executives. They have interesting and, I think, somewhat insightful things to say, so I'm looking forward to it.

Following the millennial panel, we'll take a brief break. After the break, we'll provide the committee with an update of the FDIC's regulatory review being conducted with the other federal banking agencies, in accordance with the EGRPRA -- the so-called EGRPRA regulatory review. This process is nearing the end, and our staff will
inform the committee about some of the initiatives that are underway as a result of the review process.

Then just before lunch, we'll cover some consumer compliance issues, including an interagency proposal being developed under the FFIEC to revise the existing Consumer Compliance Rating System to better reflect the current consumer compliance supervisory approaches.

After lunch, we're going to discuss some issues relating to financial technology. Senior staff will brief the committee on our efforts to better understand the system monitor intake activities, risks, and trends. We will greatly appreciate your input to help us formulate an appropriate strategy -- seems to be the current phrase, to respond to the opportunities and challenges presented by Fintech going forward.

Our last issue today, we'll cover some recent supervisory developments, including recent updates to our IT examination procedures to provide a more efficient, risk-focused IT examination approach. In addition, senior staff from our
Division of Risk Management Supervision will provide the committee with an update in some recent developments with the Financial Accounting Standards Board, or FASB, primarily related to FASB's model for current expected credit loss. It's this thing called CECL.

Finally, senior staff will provide the committee with some information about the interagency proposal that was put out for comment last month on incentivized compensation arrangements and some recently issued Q&As on brokered deposits.

I think we've tried to touch every hot button that we could come up with. I think it'll be an interesting day, and I look forward to the presentations. I'll turn it over to Barbara Ryan.

MS. RYAN: Thank you, Chairman Gruenberg, and good morning, everyone. As the Chairman indicated, we thought we would start off this morning by providing the committee with a quick update on our Community Banking Initiative, as well as some follow-up items from our community
banking conference in April.

To provide us with those updates, we're going to now hear from Doreen Eberley, Director of the Division of Risk Management Supervision, and Mark Pearce, Director of our Division of Depositor and Consumer Protection.

Doreen's going to go first, so I'll turn the program over to her.

MS. EBERLEY: Okay, thanks, Barbara. Good morning, everybody. I'm happy to give you an update this morning on the Community Banking Initiative and then some follow up activities that are coming out of the community banking conference last April and our discussion that followed that the next day.

Starting with our ongoing initiatives, Technical Assistance Videos, we issued the video on corporate governance just this week. It went out on Monday. We're working on taking a look at the Directors' College portfolio of videos and updating those and maybe adding some additional videos to the Directors' College portfolio.
Working with each of the regions to do that, as they're planning their next round of in-person sessions, and making sure that we've got a good capturing of the messages that are going out in each of the regions in the Directors' Colleges.

We did update the interest rate risk Directors' College video recently, but that's really the only one that's been updated since the original group was released a couple of years ago. We do want to get those reviewed and updated and added to as appropriate.

Following up on the conference, you all received the Community Bank Resource Kit during the conference and liked it very much. We finished the printing of those. We had done one initial printing for the conference to be able to distribute copies to everybody there.

The copying is done. We have copies for every financial institution we supervise. Over the course of the next several weeks, copies will be mailed to all the institutions we supervise with a cover letter from me and Mark highlighting
the materials inside.

A couple of the items that we highlighted were the Supervisory Insights Special Edition, a Community Bank Director's Guide to Corporate Governance. It's a little small version of our SIJ that fits in the kit that really walks through what are the expectations for a board of directors in the world of corporate governance, in terms of determining the institution's risk profile, having that conversation with the examination team, addressing strategic planning based on the business and the community that the institution is serving, and the risk profile and risk appetite of the board of directors that's been stated.

What's the difference between rules and regulations, guidance, and best practices? How do those affect how the institution operates and interacts with the examiners? What to expect during the examination process in terms of corporate governance, and just some ongoing considerations.
It refers back to the Pocket Guide for Directors, which we did update. It's got a new cover and a new look and new colors, but the content is the same. One thing that we really felt strongly about was that this was timeless, and that the duties and responsibilities of directors really have not changed since we first issued this in the '80s. It's got a new look, but not new content.

A couple of the other items that we highlighted in our letter that will go out are the technical assistance pamphlet for managing consumer compliance responsibilities, all sorts of pamphlets covering our Technical Assistance Video Program, the Directors' Resource Center, and the materials that are available on the Directors' Resource Center to help institutions, lots of material on cybersecurity, including some pamphlets that you can reprint and send to your customers. There's a pamphlet designed for consumer customers, and one for business customers, to help them increase their
cybersecurity savvy and help protect themselves and your institution.

Of course, we've updated Cyber Challenge. The updated version has the flash cards for all seven video vignettes, plus a diskette with the video vignettes on it for those institutions that don't allow access to YouTube in the institution. They can also be downloaded off of FDICconnect.

Then we've got a couple of other reprints of Supervisory Insights that we think are important and timely ones, even though they've been out for a while. One is Managing Interest Rate Risk, and the other is The Risk Management Examination in Your Community Bank. So what to expect through the examination process, how communication should work, and how we invite board and management to participate with the examiners through the examination and conversations.

Those will be -- you'll start seeing them over the course of the next few weeks. It will probably take three or four weeks to get all the
mailings out. We've got our Division of Administration handling that for us. You'll start to see those arriving in the mail soon.

We talked a lot at the community banking conference about de novos and the steps that we want to take to be helpful and supportive of the formation of de novo institutions. One of the items we talked about was hosting some roundtable meetings with organizing groups that might be interested, the consultants that work with those groups in that area, and hosting a few of those around the country.

We're starting this year with three regions: San Francisco, New York, and Atlanta. San Francisco will kick us off on September 28. We're deep in the planning for that session. I did want to recognize and thank John Tolomer for his idea that as part of these sessions, we have a panel.

Rather than just having regulators talking about what's the process and what are the best ways to approach it, let's have a panel of
successful de novo bankers talk about their experiences; what worked, what are the lessons they learned along the way that they would like to share with others? John has graciously agreed to join us at the first session in San Francisco, as well as the session in New York.

We're very much looking forward to that, think it's going to be a really good day. The agenda's shaping up nicely, and we'll be looking forward to reporting out on that at the next meeting. We'll probably have two under our belt by that time. We should have both San Francisco and New York completed by the next meeting.

We're working on our handbook for deposit insurance, which will be available later this year. In the meantime, we may be having a shorter article in our next version of Supervisory Insights talking about the process and really outlining it. So kind of an outline of what to expect in the broader handbook.

Then I'd like to mention, also, as a subset of community banks, mutual institutions.
We do maintain a special page on our webpage, fdic.gov, for mutual institutions. Every other year, we host a mutual bank conference jointly with the OCC and the Federal Reserve. The next conference is coming up week after next, August 4th, and we look forward to having that event.

The remaining items that really came out of our work streams coming out of the community bank conference related to looking at schools that are offering banking degrees and finding a way to facilitate conversation between those schools and bankers and state banking associations about how they could work together.

Just bringing together the parties, I think, will be our role. We've identified a number of institutions that actually do offer, at both an undergraduate and a graduate level -- some not both, but we've got lists of institutions that do both that we've been able to identify -- that we think we can bring together in a central location to have a conversation about what they're doing, how they interest folks in banking careers, and how
you may be able to partner with them to help find employees and look for the next generation of bank officers and employees.

We're continuing to do work on technology service providers. We certainly heard the discussion loud and clear. That's something we've been working on the interagency basis. I don't have anything ready for prime time just yet, but do want to emphasize to you that we are actively working on ways that we can ensure that institutions are able to partner with their technology service providers in an equal way.

Our guidance applies already to both technology service providers and financial institutions that they service, or maybe vice versa, the institutions that they service and the technology service providers themselves that are providing the services. We are continuing to explore ways that we can help with that relationship and make sure that institutions are well positioned to do the due diligence that they need to do and to manage those relationships, and
particularly hearing the concerns that we heard on cybersecurity and liabilities and the issues that were raised during the conference. That work is ongoing.

I would point out -- the Chairman already mentioned it -- but the new IT examination program, InTREx, our Information Technology Risk Examination Program is what InTREx stands for. We love our acronyms.

At any rate, that was one way that we tried to make -- as we worked through this process, how could we make the examination work program more transparent to institutions, and how could you better understand any concerns that we have relative to the rating system and relative to the components of that rating system.

The work program has been completely redesigned. It aligns with the rating system. We're going to start disclosing ratings -- so not to steal a little bit of Mark's thunder, but disclosing the component ratings for the rating system, as opposed to just the composite, to help
with the awareness. It's very much like when we first started disclosing component ratings in the panels. Some of you will remember that. I do.

Before that, you had to kind of guess where we were coming from. We want to be very clear, very transparent. We think that's helpful in any relationship, but certainly in understanding the risks that we're trying to talk about. That should be beneficial.

Then finally, we're conducting some research -- not too terribly sure that we'll have anything coming out of this, but it was a very interesting conversation at the conference about the pressure that institutions felt to provide liquidity to shareholders and to really be able to provide some liquidity in their share base and the different ways that we heard institutions going about that.

We've started some research in that regard, taking a look at that. At the very least, I think we'll be able to share our research. There may not be any answers or aha moments coming out
of it, but we can at least share what we're seeing. Thought that was a very interesting thread to kind of keep pulling on and taking a look at that came out of the conference. So that's the work from the RMS side of the house.

MR. PEARCE: Great, so thanks. I'll pick up with just a couple of things from the consumer protection/DCP side. One of the things you'll learn about putting up a series of Technical Assistance Videos is then you have to really pay attention when they need to be updated.

Recently, we updated our Technical Assistance Video related to flood insurance. Later this summer, we're going to release an updated version of one of our mortgage videos, the ones related to the ability to repay rule and qualified mortgage. Folks may remember that in the last year, there's been a legislative change that affects the definition of what a rural institution may be, and so we're making sure we update that and any other changes that have been made since CFPB issued that rule a couple years ago. Those videos
will be refreshed and up to date.

Speaking of the mortgage market, another way that we think we can help support community banks in the mortgage area is by providing some information about how community banks can access affordable mortgage programs. There's programs at the state level, through state housing finance agencies. Federal home loan banks have a series of programs that community banks can access, and there are also various federal programs, like USDA or FHA, et cetera.

We've been working for some time now, first starting out by talking with community banks about how they've utilized those programs to really get a sense of how these are really playing out in the field and how banks are utilizing these programs to serve their customers, and then trying to do the research to put together a resource guide for community banks on affordable mortgage programs.

Hopefully, later this summer, we'll publish part one of that that will cover a whole
series of federal programs and have not only what
are the opportunities for those programs, some
potential risks or concerns for those programs, but
also some stories from community bankers about how
they've actually utilized these programs.

We really do think that will be helpful
because a lot of community bankers, in particular,
may just not understand the different programs out
there. They all have their unique differences, so
this provides sort of a basic, hopefully
easy-to-understand guide to be a gateway into some
of the program opportunities to serve customers.

Then the last thing I wanted to mention
is over the last couple years on the supervisory
side, we have been looking at our examination
process to try to improve the risk focusing. What
that really has meant is looking, in particular,
at the pre-exam planning process.

Over the last couple years, in
particular, we have spent more time to make sure
that by the time our examiners get on site at the
bank, we have a good understanding of the bank, its
risk profile, complexity, its business model. That has made the on-site portion much more efficient. We've got a lot of positive feedback so far on that program. We decided this year to take another look at how well that's been working and ways that we can refine that. We've got a team of people internally that are taking a look at it.

One of the areas that has come up from some community banks is the number of questions that we ask in the pre-exam planning process. That has been an issue of concern for some banks, just the amount of information and questions on the front end. It's really helpful when we get all that information on the front end because it makes the on-site exam go smoothly -- or more smoothly, but we want to take a look at the numbers of questions and are we asking for the information we really need to be effective in the examination program? Those are two or three things on the DCP side.

MS. RYAN: Thanks, Mark and Doreen. Any comments or questions?
MEMBER TOLOMER: Yes, I had a chance to review or watch the video this morning on governance. I thought it was excellent. I think it would be helpful for de novos, but also, I think it would be a great reminder for current boards to look at goals and responsibilities. It was very well done.

MS. EBERLEY: Thank you.

MEMBER LUNDY: Just for a technical comment on the information updated on the flood insurance, and it might intersect with your key vendor relationships.

We've had some issues with flood insurance violations, unintentionally most of them are, related to contents not being covered. Sometimes the contents -- we can all think of a situation where the contents of a building that you take a deed of trust on are perhaps critical to the underwriting. Many times they aren't. Almost all deeds of trust have boilerplate contents included. LaserPro, which I know does the long docs for many, many community banks, it would be
helpful if they had a module that you could click: we want contents, or we don't want contents.

Typically, contents are always included in the deed of trust. Often, they're totally unrelated to the safety and soundness of the loan. Often, flood insurance is taken on the building, but it's missed being taken on the contents. That's creating a situation of unintentional technical violations of the flood insurance policy. Sometimes you do need to cover the contents, and you ought to get flood insurance on it. But I think there's a little bit of a mismatch between practical reality with the complications of the flood maps, which change, and the documentation that many banks use.

For larger transactions, where outside counsel prepare docs, very few transactional attorneys are aware of this kind of esoterica. The contents are always included in their documents. That, again, can give rise unintentionally. I don't know if you're aware of that, if it's come up through the process.
MR. PEARCE: Certainly, contents coverage, I know, has been a pain point for a lot of bankers. The deeds of trust generally do include that. I think the suggestion you made is the first I've heard of a specific suggestion that might be helpful for bankers to navigate some of the challenges there. As Doreen mentioned in her comments, we are spending some time looking at technology service providers.

On the consumer compliance side, one of the recent rules that have come out related to the mortgage disclosure updates -- I know that a number of community banks have challenges with their vendors and being able to provide software to enable them to be effectively compliant with the law. That's an issue that we're working together on to try to make sure that technology service providers that are providing software or disclosure forms are doing so in a way that helps support community bank compliance, not just the technical compliance. Your point is really enabling a solution that would help them be able
to do that more effectively.

MEMBER BLANKENSHP: I'd just like to say following our last meeting, I called and requested several of the Community Bank Resource Kits, which we received, and passed that out to our board of directors and told them that we would cover it probably in 60 days.

I had one of our directors call back and say this is great. This is really, really good because it was a summary, and they can understand it. So I applaud your idea. Honestly, I plan to pass more of the kits out to our branch presidents because it is just a good refresher. It puts in front of mind that risk factor. Every time they make a decision throughout the day, then it kind of brings it full circle, so thank you for that.

MEMBER BRYANT: I'd also like to comment. I'm on the Consumer Advisory Board. The topic of this came up at the last advisory board session as well.

MEMBER TOLOMER: Can I comment on the questionnaire? While it looks
intimidating -- because we're preparing for an
audit exam in September -- we provided the
information to the FDIC. We requested a phone
conversation just to make sure there was clarity
on all the points.

It's comprehensive, but it's not
anything that I shouldn't know. I think I wouldn't
change very much of it. As long as you have the
ability to talk to somebody to make sure there's
clarity, I think it should be helpful.

MR. PEARCE: Thanks for the feedback on
that. I do think the principle of trying to do the
off-site work so that examiners are prepared when
they get on site, I think, is something that we are
committed to continuing.

Looking at things like if you've been
through one exam, is there a way on the second exam,
so you don't have to ask them the same set of
questions? There may be things that haven't
changed and looking for opportunities to refine
that process.

MS. RYAN: Thanks very much Mark and
Doreen. We're going to move now into our next panel discussion, which is on millennials' perspectives on banking.

As Chairman Gruenberg mentioned, we've invited a group of millennials to spend some time with us, to talk about their attitudes toward banking, how they generally access and use financial services, and other interesting information.

To address these, our group is led by Stephen Simpson. Stephen, to my right, is from our New York region, where he's a senior financial analyst in our Division of Insurance and Research. He's joined on the panel by Frank Blanchard, who's an economic assistant in our Division of Insurance and Research; Greg Lyons, a student trainee in our Division of Depositor and Consumer Protection; and Michael McCoy, a student trainee in our Division of Risk Management Supervision. I'm going to just turn the program over to Stephen now.

MR. SIMPSON: Thank you very much, Barbara. I don't know if everybody has a chance
to see it, but in your packets, there should be a handout that we've provided. The title slide says: Millennials Shaping the Future of Community Banks. We'll kind of follow along through that, so if you'd like to, you can start with that.

First, I want to say thank you so much for having us here today. As Barbara noted, my name's Stephen Simpson. I'm a senior financial analyst in the New York Regional Office for the Division of Insurance and Research here at the FDIC. That means that under normal circumstances, I'm digging into the data and looking for financial trends and potential risks to the financial industry.

But today, I have a special task to come here, and I'm very excited to have some of my colleagues up here today, some of the bright young people from the FDIC, to talk about their attitudes toward banking and their thoughts and perceptions on the banking industry.

The idea behind this discussion came about from the April 2016 community banking
conference. There was quite a bit of interest at least discussed about how millennials think about banking and what kind of differences there are from prior generations. On the second page of the handout that you have, we put together the four major themes that came from that community banking conference.

The first of which was the shift in focus on the generations and the differing banking needs, primarily the discussion was between baby boomers to millennials. The second theme was the differing styles of communication and related expectations of this particular age group. Third was the dynamic landscape of technology and its role in banking. Finally, we discussed millennials in the workforce, and there's a real focus on attracting and retaining that talent.

I've prepared a set of questions to lead us through this discussion, but I've also made sure to leave time at various points in the discussion for the advisory council to provide any input or questions or just general comments that you'd like
to add. I think I'll start out by introducing our
panelists. Then, what we'll do is we'll give a
little bit of background into the millennial
generation, who that refers to, and what makes this
group so different from our prior generations.

If we could start, maybe we'll just go
down the line. Frank, do you want to give us a
little bit of background about you?

MR. BLANCHARD: Sure, thank you, Stephen. It's a pleasure to be here. My name is
Frank Blanchard. I'm an economic analyst in the
Division of Insurance and Research. I've been
with the FDIC for approximately four years now.
I'm originally from Virginia Beach, Virginia, and
I went to school at James Madison University.

MS. KRAMER: Hi, my name is Katie Kramer. I'm originally from Naples, Florida, and
then went to Marshall University and got my
undergraduate degree in economics, and then an MBA.
I am also in DIR working as an economic assistant.
I've been here for about one year.

MR. LYONS: My name's Greg Lyons. I'm
a graduate research assistant within the Division of Consumer Protection. I've been here only about six months now. I got my undergraduate degree in policy analysis from Cornell University and am earning my master's in public policy from Georgetown. Student loans will obviously be a big part of the discussion for me. Happy to be here, thank you so much.

MR. MCCOY: Good morning. I'm Mike McCoy. I'm an intern with the Division of Risk Management Supervision. I'm a 28-year-old retired Army veteran, who's originally from Pittsburgh and is currently attending Robert Morris University for accounting.

MR. SIMPSON: Thank you. Before we shine the spotlight on my colleagues' opinions up here, I thought it would really be helpful to take a step back and look at the larger population of millennials and just sort of frame our thinking. If you would, you could take a look at the pie chart on the next page, on page 3, there, of the handout in front of you. We'll start by identifying who
the tagline millennials really refers to and what makes them such an omnipresent part of our conversation.

Putting an exact born on and expiration date on generations is a bit of a nebulous task because usually, when we talk about generations, we're talking about aggregated social trends and behavioral patterns. But as a fairly loose definition, when you hear the term millennial, it generally refers to the population born between 1980 and 2000.

I'm going to take a little bit more of a refined look by including only the group of young adults that had reached the age of 18 to 34 as of the end of 2015. That's a very specific subset. It makes the oldest millennials born in 1982, and it makes the youngest millennials born in 1998. I'm going to do that for two reasons.

First, it gives credence to me as an impartial moderator because I am well outside, unfortunately, of that demographic. Second, and probably more importantly, is that there's several
mainstream and comprehensive studies that have been provided, one of which I'll refer to a lot is from the Pew Research Institute, and another one's from Nielsen. It gives us a bit of a consensus to rely on, and I can steal some of those statistics.

Using the definition born in 1982 to 1998, the most recent full estimate available from the U.S. Census Bureau identifies the millennial population at a little over 74 million as of July 2015. That's a full year ago, but that's the most recent data. If you look at the pie chart, you can see that's about 23 percent of the U.S. population, which puts them right in the same category as baby boomers, in terms of the overall size.

Now, there's more recent estimates that will come out, obviously, in July 2016. Some of those estimates have already trickled out. They're as high as about 84 million, which puts the millennial population at about 25 percent of our population, which makes the largest cohort of generations in the U.S.

Now, not only is the sheer size
important, but also, this demographic is rapidly approaching its sort of critical stage in their lives. The youngest millennials are approaching their financial independence, and the older millennials are rapidly approaching their prime earning years. As a result of that, they quite literally become everybody's target market. They're getting a lot of discussion out there.

In the next few slides, I'm going to refer to some of the other generations. Just for clarity, Generation Z generally refers to the youngest generation alive right now. That's from 1999 through present. Millennials, of course, 1982 to 1998. Then we'll talk about Gen X precedes them, so they were born 1966 to 1981, baby boomers, post-World War II to mid-1960s, and then silent generation. The greatest generation's still out there, but they represent a very small piece of the demographics, so we won't really refer to them much.

If you follow me over to the next page in your handout, page 4, I'd like to talk about what
makes millennials so different from the prior
generations. There's no shortage, unfortunately,
of statistics out there on millennials. Believe
me, I had to sift through quite a few.

But one that I found particularly
profound was that U.S. Census data shows that in
1975, three out of every four 30 year olds held a
job, owned a home, and had started a family. By
2015, the share of 30 year olds that had tackled
those same life events fell to just one in three.
It's been a huge change. These life cycle changes
can be further broken down by looking at several
milestones.

First, it's taking millennials a little
bit longer to figure out a defined career path.
The 2015 Pew Research study that I was referring
to earlier noted that 30 percent of males age 18
to 33 are either unemployed or not in the labor
force. That's compared to about 20 percent for the
prior generation, for Generation X, and 37 percent
of females are either unemployed or not in the labor
force, and that's compared to 31 percent. So quite
a bit higher unemployed or not in the labor force rates.

Second, marriage is becoming more of a capstone type of event. It used to be that you would graduate college, partner up, and then sort of tackle life's challenges together. But today, that's becoming more of obtain financial independence, and then go down the marriage route. According to that Pew Research study, 28 percent of millennials are married, and that's compared to 38 percent of Gen X, 49 percent baby boomers, and 64 percent of silent at the same age. That's sort of a prolonged trend that's really getting a lot of play time.

Millennials also have a tendency to choose to live in city centers. Similar to the trend before, it's a long-term trend, but 86 percent of millennials live in a metropolitan area. That's compared to 83 percent of Generation X, just 68 percent of baby boomers, and 64 percent of silents at that same age.

Millennials also have a tendency to be
more educated, or at least attain higher levels of education. Fifty-five percent of males age 18 to 33, and 64 percent of females, have at least some college education. That's the highest among all those generational cohorts.

They're also savers. They grew up with the great recession. It impacted their formative years, which affects how they think about money and personal finance. On average, millennials start saving at age 22. That's five years before Gen X and 13 years before baby boomers. They also proportionately save more. Millennials are saving around 8 percent. The long-term average for their predecessors was around 7 percent of their income.

Millennials have a tendency to be socially connected. This is the one that we always hear about in the mainstream media, but it's true. They grew up with social networks, and they care about social issues. I read that 84 percent had made a charitable donation in 2014, and 70 percent had volunteered at least one hour of their time,
which I think is very high.

As a corollary, they grew up in a golden age of information technology. That's kind of what we hear about so much is that they're very comfortable with trying out new technologies. They're early adopters of those technologies, and they're very comfortable with making decisions based solely off of online or web experiences.

What do these demographic and social differences really imply? There's a few key trends that are noteworthy. First, housing formation had been affected due to the delay in marriage, which affects the timing of your initial home purchase. It also affects the timing of subsequent home purchases because you don't outgrow your first home and have the need to get a second home.

That second theme, in terms of urbanization, housing affordability and preference have pushed millennials into city centers. That's not only affecting the purchase of houses, as well, but it's also affecting auto
lending. If you live in the center of the city, you're less likely to need to buy a car, and even more or less likely to buy multiple cars.

The more college education that we talked about, that's led to student loans. Greg already mentioned that a little bit, but two thirds of bachelor degree recipients have outstanding student loans with an average debt of about $27,000. It's a big number. Two decades ago, only half of recent graduates had college debt, and the average was down around $15,000. So that's quite a bit of growth, not only in the amount, but also the percentage of. That also affects affordability because that's part of their household debt. Being able to afford a home is impacted by that, as well.

Lastly, they're more apt to research, identify, establish, and maintain relationships with businesses based solely off of their web or online experiences. That impacts the way that we do business with millennials.

All these trends add up to one thing
that we're getting at here. That is they have a
very different banking relationship and a very
different outlook on banking.

Now that we've established a little bit of
background about millennials, at least from a
very high level, now we can focus in and shine the
spotlight on our panelists here. I want to point out, though, that the views expressed today are
their opinions. They don't necessarily represent
the FDIC's opinions.

With that, we'll talk a little bit about
how millennials use financial services. I think
we'd like to hear a little bit about how you came
about to choose your bank, and maybe elaborate on
the biggest factors that played a role in your
choice of banks. Maybe we'll start the opposite.
You want to start, Michael?

MR. MCCOY: Sure. I grew up in a very
small town, about 3,200 people. Despite living in
more than a dozen locations worldwide in the last
decade, I've maintained my relationship with the
local community bank, predominantly because the
branch manager was a baseball coach of mine for about a decade. The loan officer at that branch was in high school with me. Essentially, everyone in that building knows my name. I know their names. The reason that I've stayed with them, despite not having great access over the years, is because I know and trust the people at the institution.

MR. LYONS: Similarly, I grew up in a small town. When I was 10, I opened up an account with our local community bank. I really did enjoy the service there, but when I went off to college, there was no way I was going to be able to continue banking with them. They didn't have online or mobile services, and there were no locations near my college.

I switched to another institution just simply because of the name. I just picked a big bank. I wasn't very savvy about it. I stayed with them up until in my final year at college -- it comes down to cost and convenience, at this point.

At one point, I bought a $4 snack in the
middle of finals week. Unknown to me, I got charged with a $35 overdraft fee. As I was leaving from that purchase, I decided to get a drink, as well, got hit with another $35 overdraft fee. I left the bank a week after that.

After that, it really was just about finding a bank that could offer me a convenience. That was exclusively online access. It was mobile access. I knew I was going to be traveling a lot for work. I've lived in five states over the last three years. Things like being able to deposit checks online were important, but it really just came down to that convenience factor.

MS. KRAMER: I also have a community bank located only in Florida. I first opened a, I think, joint checking account there when I was in high school and haven't really found a reason to leave because I pretty much bank just based off of the web and a mobile app on my phone. One thing that was also very helpful is refunded ATM fees, studying abroad, as well, those were all refunded, so I could get cash there. So yes, the president
is a family friend, so I haven't really found a
reason to leave yet.

MR. BLANCHARD: My initial selection
for my financial institution was done by my
parents. They set up a savings account for me
there at an early age. And I just maintained that
relationship with them because they had a large
footprint on the East Coast, and they do offer a
lot of the online technologies that Greg was
mentioning. They had mobile banking, good web
applications, and also, they are part of a large
ATM network, so whenever I do need to get cash, I
can get that without the fees.

MR. SIMPSON: Clearly, the earlier you
get reached, the better. I also hear a lot of the
sort of like, the technology issue, in terms of
convenience, the refunding of ATM fees. That
helps you, obviously, if you're not able to reach
a branch or able to reach an ATM. The web apps,
certainly hear a lot of that, but really, the main
theme is trust and establishing a relationship,
right? Trust and establishing a relationship. I
know we're all very interested to hear about the technology aspect. Maybe we could start by talking about what products and services you currently use, and what touchpoints or technology you rely on to access your account. Greg, do you want to start?

MR. LYONS: Yes. My primary touchpoint with my bank is through the mobile applications they have. I don't do any transactions there, but I just review my finances, just to know what's going on. In order to shift funds, things of that nature, I do most of that through their online application.

I'm a little different than the panelists here. I have not been in a brick-and-mortar location for my bank since 2013, even though they have a location that's within two miles of my house. I do use third-party apps, in some instances, to also track. Being able to sync up with those is useful. Like I said before, being able to deposit checks through a mobile app is also helpful.
MR. SIMPSON: How about you, Katie?

MS. KRAMER: I pretty much just use check cashing. That’s a separate app for my bank. I can take a picture of it, and it’s deposited. Then I do also transfer funds via an app and get a text message and an email sent when that happens, kind of a fraud alert message, and then bill pay services. I also do that online.

MR. SIMPSON: Frank?

MR. BLANCHARD: Additionally, I use the web and mobile applications. I use the mobile check deposits and the online balance transfers. Additionally, I use some third-party applications, such as Samsung Pay, which my financial institution has teamed up with. That helps add a layer of security.

MR. SIMPSON: Michael, how about you?

MR. MCCOY: My primary touchpoint is an actual brick-and-mortar location. I use online strictly to check and make sure that people have cashed checks that I’ve written. I don’t use mobile. I’m way off from the rest of the panel on
that. In my town, banking is still a social experience. You go in, have a cup of coffee, sit down. You don't run in for five minutes. It's a good half an hour catching up with people and chatting.

MR. SIMPSON: So Greg, we heard from you it sounds like it's not important at all to have physical access to a branch, and then Michael, it sounds like it is very important to have physical access to a branch. How about for you, Katie, and for you, Frank? How likely are you to go into a branch? How important is it to you to be able to go into a branch?

MS. KRAMER: If I were to get a big loan, I would want to, I think, do that face to face. But with my bank being in another state, as long as I can pick up the phone and call someone that I know and my bank's helpful with that, I really don't need to physically go in.

MR. SIMPSON: All right. And Frank?

MR. BLANCHARD: It's not really that important, but I like to know that if I really need
to go in to the institution, I can go in to a branch that's nearby. Because I have branches, again, like I said, they're all over the East Coast, so I can access them whenever.

MR. SIMPSON: I know we talk about life events. You said if I needed to get a big loan. Does anyone on the panel see their banking service needs changing rapidly or in a major way? Greg, do you?

MR. LYONS: Absolutely. As I mentioned, student loans are definitely going to be part of my life for a long time. I already started getting mail from people about consolidation or other sorts of services they have. I haven't taken up anyone on that yet. I will have to consider that as those become more pressing. I will likely have to look to different institutions as I consider a mortgage or other things. I'm not necessarily tied to my primary institution. It's just where I am at this point.

MR. SIMPSON: Okay. Michael, how about you?
MR. MCCOY: I've got pretty deep ties to my bank already. They hold one of my mortgages. They hold one of my car loans, my boat loan. I don't really see myself moving from them anytime.

MR. SIMPSON: Bucking the trend with the house and the boat. Greg, you kind of gave me a good segue into the communication styles, in terms of you've already been receiving information about your student loans. There's a lot of talk about how the style of communication is important in being able to reach millennials. What's the best or most memorable way that a financial institution has reached out to you, and what made that approach so effective for you guys? Katie, can we start with you?

MS. KRAMER: I do get lots of emails and mail from different financial institutions and, honestly, delete the emails or rarely open the mail. But the most memorable touchpoint, I think, from my own bank, has been that they send me hand-signed Christmas cards and birthday cards, I think. That is just kind of a nice way to, again,
to not see the people who work there, but to know that we have that relationship.

MR. SIMPSON: Right, to get touched by them twice a year. There's nothing wrong with that. How about for you, Frank?

MR. BLANCHARD: Same. Whenever I get an email, I'm pretty much deleting it or throwing the mail away. Basically, it's actually more me reaching out to them. I know that whenever I call my financial institution, I'm talking to someone, not a machine or anything like that. I'm talking to someone within under a minute, and it's good to know that someone's always there, ready to pick up the phone for me.

MR. SIMPSON: Greg?

MR. LYONS: This is the fact that most of us did start these relationships during the financial crisis. For me, the most effective marketing was always trust based. As I mentioned, that middle institution I had that charged me $70 in overdraft fees made me feel kind of like I was a product, a line item. And so marketing that I
see that focuses on consumers, rather than services, tends to influence me more.

MR. SIMPSON: Michael?

MR. MCCOY: I tend to get a lot of paper mail, especially refinance your mortgage, refinance your car. I don't open it anymore. I just throw it away. What's important to me is the fact that I can pick up the phone any time that I need to and call and get somebody at my bank. They can explain whatever it is that I need explained. It's all about that personal contact for me.

MR. SIMPSON: Pretty easy to summarize that, right? It's maybe not as important the bank's reaching out to them, but important to be able to get a hold of somebody, and them being able to reach out to you. How about researching online? If you're looking for things, is that sort of your primary method? That would be where you would start, or would you have a different method? You would reach out, call them, go to a branch, something like that? Greg?

MR. LYONS: I've actually expanded
services through my banks a couple times after calling them. I will either have a question about something I saw on their site online, but I've opened two or three different products with them just based on being able to reach somebody immediately and have somebody come up with ideas for how we can rectify that.

MR. SIMPSON: Katie?

MS. KRAMER: I usually would go to the website.

MR. SIMPSON: You guys all indicated that you have fairly established banking relationships. I guess, Greg, yours maybe isn't quite as relational. Is there anything that a bank might offer you that could make you switch banks? Michael?

MR. MCCOY: I've got pretty deep ties. I feel like it would be very difficult to get me to move from my current institution. You would have to be offering something extremely comprehensive. The start of that is it better be somebody I know that's contacting me.
MR. SIMPSON: Okay, and Greg, how about you?

MR. LYONS: I'll admit that yes, I'm relatively transactional. As I mentioned earlier, with student loans or mortgage products, there are absolutely things that could be pitched to me to get me to switch.

MR. SIMPSON: Katie?

MS. KRAMER: I think a similar answer to Greg. If I'm looking for a mortgage or looking at different rates or whatever, I would definitely, probably compare between banks, but at this point ---

MR. SIMPSON: Okay.

MS. KRAMER: I don't ---

MR. SIMPSON: A painful phone call to your family president. How about you, Frank?

MR. BLANCHARD: Similar. If I'm shopping for rates, like getting an auto loan or a mortgage, I would definitely check other financial institutions.

MR. SIMPSON: In shopping for that,
would you start at your bank? If, for example, you're going for a home loan, you would just start at your bank immediately?

MR. BLANCHARD: Sure. I would look at the rates in my bank, and then start to branch out from there and compare.

MR. SIMPSON: I think, again, I hear a lot of the relationship issue, but certainly there's the convenience factor plays a big role with at least this panel. Before I switch gears a little bit and really delve into millennials in the labor force, when you talk about some of that, I want to make sure I give you guys an opportunity to -- if there's anything that comes up that you'd like to talk about. Yes, ma'am?

MEMBER BLANKENSHIP: I'd just like to ask Frank, so you said you would shop rates if you were looking for auto or mortgage. If you found a lower rate, would you go back to your bank and ask them to match it?

MR. BLANCHARD: Absolutely.

MEMBER WILLIAMS: One of the things I
think I keep coming back to -- and I have three millennial daughters. We were at my middle daughter's house and my wife was looking for an envelope. She said, Betsy, do you have an envelope? She said, no. She said, how do you mail your bills? She said, I don't mail bills. What are you talking about? But the thing I keep hearing, and the thing I think is community banks' ace in the hole, I hear you guys talking about relationships and being able to talk with someone that you know or being able to talk to a human being -- Greg, even in your situation, a little more transactional. I keep looking at the fact that it appears to me that millennials are -- given the choice between a Home Depot or a Lowe's and a neighborhood hardware store, where you know people, the tendency is to go to that neighborhood hardware store.

I get that impression. Given the choice between a local coffee shop and a Starbucks, you might tend to go to that local coffee shop. Am I missing that, or are we on track? Because I think
that's our ace, as far as I'm concerned.

We're not going to be able to offer, probably, the entire plethora of products that are out there from some of the bigger banks, but we can offer that service and having a human being answer the phone, somebody that you know. That's got to be the ace for us is having, really, as I refer to it, the best of both worlds, the technology to get it done, but the back door of always knowing you can pick up that phone and call somebody. I keep hearing that theme. That's not just you four, right? That's the rest of --

(Laughter.)

MEMBER WILLIAMS: Am I missing the boat on that, or are we pretty much -- that's going to be key for us isn't it, is community banks?

MR. LYONS: I think you're absolutely right. There's a huge opportunity here because large institutions, for a while, were needed for transient millennials because that was just the only way to get money. Now, if you have good enough services online, you don't need somebody with 1,000
locations. You could use somebody with five.

MS. KRAMER: If information is readily available in the same way as a large bank, I think that would be the preference.

PARTICIPANT: You'll take that every time. Good.

MEMBER HASKIN: Let me ask you this question. If you can't contact someone on the weekend, does that pose a problem? Is having immediate access to a real live person a necessity?

MR. MCCOY: I don't know about anybody else, but my branch manager was a baseball coach of mine. I'll pick up the phone and call him on Sunday if I have to. When you've got their cell phone number, you're good forever.

MEMBER BRYANT: Michael and Katie, you appear to be very loyal and relations --- have strong relationships with the institutions. The one thing that I picked up from all four of you is that peddling products to you, whether it's online or through the mail, is not something that gets your attention.
MR. MCCOY: No, even if it's something that I need, I don't like it when people --- especially when we come to the idea of everything that you do online is tracked, and everything feels a little bit analyzed. I really don't like things that are specifically tailored to me popping up. I just feel like there's a degree of intrusion there that's a bit uncomfortable.

MEMBER THOMPSON: Even if it comes from your bank, that still is not interesting to you?

MR. MCCOY: Luckily, I don't have that experience with my bank. They don't send me advertisements. We're a generation of people who, the second we have a question, we're on our phones, and we're looking up the answer in 15 seconds. That means that products are -- it's almost better just to be known as a presence, to have a bank -- I don't mind banks reaching out at all just to effectively say we're here, just in case you have these issues, as I said, conveying that sort of trust message. I do feel that people my age, if we have a question about something, we'll do that.
We'll take out our phones, and we'll look it up.

MEMBER BRYANT: Here's a follow up experience my wife and I have had. We had a car salesman who's 18 years old. When you drive to the lot, he might come out to see you. And if you come in, he'll give you his card. He says, I'm not going to try to sell you something you don't want. You've done your research. You know what you want. Once you've decided, come see me and we'll make it happen. Is that the type of person that gets your attention?

MS. KRAMER: For me, absolutely.

MEMBER BRYANT: This guy is the No. 1 salesman at his dealership in Louisville.

MR. MCCOY: I'm actually going to relate directly to that. My most recent vehicle purchase, I walked in, walked to the first salesman, told him, this is what I'm looking for. This is what I want. These are the options I want. I know what dealership invoice is. Set me up. He sold a car in 15 minutes, without having to do anything. I feel like that's big for our
generation because we have access to this volume of information. If it's something that we want, especially on these larger ticket items, we're really going to dig in ourselves. Because honestly, there's a bit of institutional mistrust after 2008.

MEMBER CASTILLO: Let me ask two or three questions. You talked a little bit about using a website to collect the information. How much information are you looking for? For example, if you're looking for a loan, are you looking for pricing, fees, all-in costs, application, being able to do that online, or are you looking for -- you've got a general idea of what's available, and then picking up the phone and talking to somebody?

That's one question. The second question is as you consider a financial institution, does the fact that we're FDIC insured, does that cross your minds at all? Is that something that you assume is there, or do you even care about whether that insurance is available?
MR. MCCOY: I find seeing that little placard in the bank nice and comforting.

MS. KRAMER: We're FDIC employees, so yes.

(Laughter.)

MS. KRAMER: But having said that, I would say that most millennials probably don't look for that plaque, if I'm being honest. I think it's honestly assumed.

MEMBER LUNDY: Did any of you ever look for that before you came to work for the FDIC, if you can recall? Would that have been important to you before you ever had this job, or did you even think about it?

MR. LYONS: IndyMac wasn't that long ago, so I think the knowledge that there is a safety net is very important. I would be very -- I don't think I'm alone in my fears that I'd be very worried if I saw that an institution didn't have that.

MR. BLANCHARD: There is some lack of information out there. I have friends that when I've talked to them about institutions not being
FDIC insured, they go, what? That's possible to do that? And so I inform them now, that they become more aware of that. I would say the majority of people I know, they don't look for the plaque. They just assume that it's FDIC insured.

MEMBER BRYANT: Even with apps like online to non-traditional lending they're comfortable with it?

MR. BLANCHARD: I'm not too familiar with that. I don't know of a lot of people who have done that.

MR. SIMPSON: I have to say that the less known we are, the better off everybody is. It's not a bad thing when somebody has to ask you what the FDIC is because that means we're not in the news about something about banks needing to access our funds. I just want to redirect into that sort of labor force issue. And that way, hopefully, we'll leave a little bit of time because I think we're having a very good discussion, but I want to make sure we cover everything. Switching gears a little bit, in terms of the labor force,
what are the most important factors that you guys considered in choosing your career path? Maybe Katie, we'll start with you.

MS. KRAMER: In my graduating MBA class, I think a lot of people went to go work for big companies. Not that there's anything wrong with that, but I knew that I did want to have meaningful work, and not necessarily purely work for the bottom line, kind of, with the main goal being profit. Not that there really is anything wrong with that, but the mission of the corporation here is very well known.

It's a very integral part of our work. Personally, I think that is a big reason why I do enjoy my job, because you can see the effects of what the FDIC does play out throughout the economy and financial system. That was important for me, as well as location and some work/life balance, just being able to maintain personal priorities, while still working hard.

MR. SIMPSON: Frank, how about you?

MR. BLANCHARD: The largest factor I
was looking for was where I was located. Growing up in Virginia Beach, it is a metropolitan area, but it's not a traditional one. It's based on the tourist industry. I was looking for something more city-like, so New York, Washington D.C., and also somewhere on the East Coast. D.C. definitely checked that box. Additionally, I was looking for a job that, because I'm going to be living in a metropolitan area, a job with a decent salary, so that I could actually live there, because that can be challenging now.

MR. SIMPSON: How about you, Greg?

MR. LYONS: So I might not be the target market because with a degree in political science, and then a Master's in political science, I have fairly limited options.

(Simultaneous speaking.)

MR. LYONS: For me, the place that I work, there's two things that really drive me to look for someplace. One is a sort of mission focus, but the other is that I really look for places that I believe are meritocratic, where if
I come in and I work very hard, I have the possibility of moving up the rank there. Immediate benefits, to me, are less important than the opportunities for mentorship and my overall trajectory within a company.

MR. SIMPSON: Thank you, Michael.

MR. MCCOY: Having completed one career already, I'm used to work that was extremely physically challenging. When I started looking around after that, I was looking for something that was equally challenging in the intellectual field. Doing something that's going to keep my mind stimulated was important to me. At the same time, I wanted to have a good degree of work/life flexibility. I feel like I've worked my share of 14-16-hour days. Comp was slightly less important, and maybe a little bit more time off, a little bit more balance.

Unlike a lot of the other panelists, a metropolitan area was not important to me. I like to be convenient to the fishing and the boating and the camping. D.C.'s not exactly my ideal
location, but the work here is worth the trade-off.

MR. SIMPSON: Again, to relate back to the themes, I hear meaningful work and community-type involvement. That certainly relates to the theme. Then the obvious is the urbanization sort of deal. But again, these are not randomly selected.

These are all FDIC employees from here and Washington, D.C., so it makes sense that they have a stronger feeling about that. What do you perceive as the benefits of working in a smaller company versus working in a larger company, or if you have experience in each, then maybe talk about that. Frank, do you want to start?

MR. BLANCHARD: There's pluses and minuses to both. In a smaller company, it's more intimate setting. You can be closer to your co-workers and really operate more efficiently in a team environment. But also, there's those pressures to maintain contracts and other outside pressures such as that. In a larger company, there's a perception that you could just be another
cog in the system. I know especially millennials nowadays, they like to be more individualistic. That can be a big turnoff for working in a large company.

MR. SIMPSON: Katie, how about you, small versus big?

MS. KRAMER: Same kind of themes. There's definitely the perception that you can have a closer relationship, I think, in a smaller organization, maybe some more mobility upwards in a larger organization. But I think, at the same time, it depends. At a larger organization, you can be in a smaller group of people working day to day and form those relationships.

MR. SIMPSON: Greg?

MR. LYONS: I think one of the stereotypes of millennials is that we tend to be very impatient, that we expect things immediately. For many of us, I think that there's a preference to work in smaller institutions because, as I got back to that point about meritocracy, you feel that if you work very hard within a small institution,
that will be recognized.

You'll have more of an impact on the organization, and you will hopefully rise up faster. There are more mentorship opportunities within large institutions, in my experience, but I think that there's a preference for small.

MR. SIMPSON: Michael?

MR. MCCOY: I feel like I've run the gamut a little bit on this. I've worked for a company that was a grand total of eight people in my hometown when I was a teenager to the 415,000 people that the Army employees. I've seen both sides of the coin.

I kind of have issues with both. With smaller institutions, it kind of feels like sometimes, regardless of how well you do, somebody's got to retire for you to move up. With a larger institution, sometimes it feels like you are a cog. To me, there's an important balance there. It needs to be easy to move forward in your career, but at the same time, you want to be doing work that makes you feel like you're accomplishing
something and contributing.

MR. SIMPSON: I want to make sure that I leave time. We have about 15 minutes, it looks like. I want to make sure I leave time because I know as presidents of banks, this is a very important topic to you, as well, staffing the appropriate levels at all levels of an institution. Then, of course, we hear from examiners about succession planning and things like that. If there's some more questions about that, then we can always go back, as well, to prior topics. Yes, ma'am?

MEMBER BLANKENSHIP: I'd like to just ask the question -- I think each and every one of you said something about work/life balance and how important that is. We're currently reviewing our employee handbook, which probably has -- most of the bankers here, we haven't really changed our PTO policy, the two-week vacation. We do now allow that to be split, but believe it or not, that went decades and decades. Was that a big factor, and do you look at flexible PTO? Is that pretty
important to you?

    MR. MCCOY: For me, absolutely.

    MR. LYONS: Flexible PTO is almost less important to me than telework opportunities, especially depending on where I live.

    MS. KRAMER: It's important to me. I have friends where I went to school in different states and family at home. So to be able to take a Friday or a Monday off and have a long weekend is very nice for me.

    MEMBER BLANKENSHIP: How about you, Frank?

    MR. BLANCHARD: I would say it's very important to me. Initially, it wasn't so much because leaving college, I was finishing up summer break, and I still assumed that the rest of the world had summer breaks, but ---

(Laughter.)

    MR. BLANCHARD: Learned that lesson really quick. Understanding that the company I work for or will work for has a good PTO system, I think that's very important.
MEMBER BLANKENSHIP: I think as community banks, particularly, we're kind of behind the eight ball. And the reason --- I have millennial daughters, as well. My middle daughter just went to work for an accounting firm. She got more vacation than I have. But that is a huge benefit and, I think, something that will snag millennials and keep them as part of your labor force. It's something that I think we're challenged with, taking a step back and seeing how we could be more flexible in that regard.

MEMBER WILLIAMS: I also heard a recurring theme of mission focus, that there's some -- you see the results of your work versus the factory mentality, put the bolt here and put the bolt here. That's something I keep hearing. I think that's probably something we need to do a better job of as leaders in community banks is making sure that we're spending time sharing the overall focus of what we're trying to accomplish in our communities and making sure people understand that they have a hand in making that
happen, so that's good to hear because that's another ace, I think --

(Simultaneous speaking.)

MEMBER BRYANT: When Stephen introduced each of you or you introduced yourselves, I don't think I -- normally you guys don't move into urban areas, but we have so much technology and you can communicate with people all over the world. From your conversations with friends and peers, what's driving the modulation from rural, small communities to larger urban areas?

MR. MCCOY: I think opportunity has a lot to do with it. Pittsburgh has kind of gone through a renaissance over the last few years and has recently been ranked as the No. 1 place for recent college graduates to move. I think a lot of that has to do with the vast array of opportunities that Pittsburgh offers, not just in financial services, but in tech and industry, as well.

MR. LYONS: For me, my hometown, over
the last, actually, two years, has lost about 1,000 jobs, in a city of 17,000 people. Most people just recognize that they can't stay somewhere that's in decline. The feeling is that even they try to start their careers there, they would have to move at some point anyway. There's a feeling that there's more opportunity, especially at the start of your career, in a larger city.

MS. KRAMER: I think I agree. There are probably different events held in big cities. In D.C., for example, there's festivals on weekends. Of course, you have the political arena here, and things like concerts and that kind of thing, where it is an exciting place to be for young people. There's definitely a large proportion of young people here. But at the same time, I also like to go hike at the national park nearby and that kind of thing. I think people are interested, especially with technology, in different areas and different --- there are rural areas with other things that interest young people. But again, we are four people who live here, so a little partial.
Mr. Blanchard: Not just job opportunities, but overall convenience. I live within a 15-minute walk to work, so I can minimize my commute by living in the city. Kind of what Katie was saying, there's a lot going on here. I can walk out of my apartment door and be anywhere within 20 minutes, just walking, so I also get my exercise, as well. I have a car, but I might drive it once every two weeks. That's just to make sure she still starts. It's a she.

Member Tolomer: First of all, Michael, thank you for your service, appreciate it. What would keep -- I don't want to make this an FDIC thing, make it uncomfortable, but what will keep a millennial in the job that they pick? Assuming all the things that we've talked about, and now you're working at an organization -- let's not make this an FDIC issue, but what will keep a millennial in the job?

Mr. Simpson: That's an important question. Frank, do you want to start?

Mr. Blanchard: Sure. I think we were
talking about earlier, being able to see that our
work we're putting into it is showing results. Not
that you need recognition, but you know that
whatever you are doing, you're not just running a
report just to run the report, for the sake of
running a report. You know that it's going
somewhere; it's actually being utilized. Also,
just promotion potential, knowing that you know
that you're not going to be pigeonholed in this
position. You have that option -- not necessarily
promotion, but there are training-based programs
out there to help you learn more.

MS. KRAMER: Right. I would say,
again, not necessarily a promotion by a new title
or anything, but just the ability to not do the same
thing every day, to grow in your job and have some
new tasks, maybe feel -- for a small company, in
my opinion, it would be to feel like you have some
say in the long-term strategy of the corporation,
or at least to just be informed and forward looking,
and then, right, just receiving new challenges.

MR. LYONS: I don't think that if you
have any millennial employees that they're going
to want to be the president of the bank in a year.
There is the knowledge that you have to put in the
hard work. Things that will keep them there, in
my mind, are not even necessarily mentorship, but
feeling that they have some knowledge of where the
company's going, the feeling of they're learning
about the industry, itself, the feeling that
they're learning things that will help them if and
when they're ready for a promotion down the line.
I think that millennials are very quick to jump off
of a job that they don't feel is going to help
elevate their career.

MR. MCCOY: I tend to agree with a lot
of what was already said, but I think one thing that
we kind of missed focusing on is when I come to work,
I like to come to work. It's important for me to
come to work and know that I enjoy the people that
I work with, and I enjoy the work that I do. Work
dissatisfaction tends to bleed into personal
dissatisfaction for millennials, so part of it is
also the culture of the corporation. It should
feel like home.

MS. KRAMER: I think no matter what you're doing, if you're with people who are excited about it and passionate about it, it's definitely a place you want to be.

MR. MCCOY: Even if you get to the point where the work kind of gets tough or frustrating, you're not really sure why you're doing it, if you're doing it with people that you enjoy doing it with, a lot of millennials will ride that feeling out.

MEMBER LUNDY: You are obviously a small subset. You're all well-educated. You all work at the same place. Are the trends that were talked about here, in terms of saving loans or perhaps lower credit card debt -- you mentioned student loan debt. As you look at your peers, do you think that they are more debt averse than maybe Gen Xers? What's your attitude towards that issue?

MR. BLANCHARD: I would say they're probably more debt averse. That's why you do see
a lot of people waiting to get a mortgage. You just continually rent for a while. They don't want to have that big burden on the books.

MR. LYONS: I'd have to disagree. The millennials that I know, the reason they're not buying a home is because they can't put 20 percent down on a home in D.C. I'm not sure how many other people can, either.

PARTICIPANT: I'm not sure how many of us can.

MS. KRAMER: It's a little hard to compare because we run around and -- we didn't know the generation ahead of us at this age. I do know many people who are saving.

PARTICIPANT: Who are saving?

MS. KRAMER: Mm-hm.

MR. SIMPSON: If you don't mind me asking, do you guys all pay your credit card balances the second you get your bill, or do you keep a running --- yes.

MR. LYONS: The one thing I'll point out, though, is that I think people in our age
bracket are sensitized to debt early on because they are taking out a massive amount for student loans. They're not necessarily shy of tacking on debt. I think a lot of us have the feeling that because we're savers, we want to have homes, because then we feel like we're building equity, rather than just throwing away money at the end of every month. There is a desire to save, and debt is sometimes seen as an avenue to help us build assets.

MEMBER CASTILLO: Let me ask a question. You mentioned that you're not familiar with the prior generation, what that experience was. Do you experience, or do you sense inter-generational challenges as it comes to certain things? For example, you all grew up in the digital era. That's when you went to school, you were starting in your professions.

There's folks like me that sometimes we struggle with the technology that's available and getting used to texting your child because they're never going to answer your phone call, but they'll
respond immediately to the text. That's one question, if there are any challenges there. The other is I think some people of my generation believe you're not doing your job unless you're working 50-60 hours a week to get ahead. The work/life balance is something that, for some older folks, is a little bit foreign, if you will. I guess the question, in a long-winded sort of way, do you run into generational type of challenges, and how do you address those, and in what areas?

MR. LYONS: Getting to your last point about balance, I attend school in the evenings. I'm a part-time student there. Everyone in my program is working full time. They're attending classes at night. I felt that I had too much time, so I'm also assisting a professor for 10-15 hours a week on another research project. I think that's not uncommon. There's the feeling that we need to put in a lot of work to get where we want to be. I think that the assumption that millennials might be lazy or feel that they're entitled to a promotion just because they show up 9:00 to 5:00 every day
might be misguided.

MR. MCCOY: I agree with the assessment there. There tends to be this belief that millennials are sort of lazy, but as far as I'm concerned, the truth is when I leave here in August and go back to school, I go back to taking 18 credits while working 50 hours a week at a local accounting firm.

MEMBER WILLIAMS: To be clear, I wasn't suggesting that anybody ---

(Laughter.)

MEMBER WILLIAMS: --- especially you folks, were lazy. I think, really, the point is there's 40 hours set aside for work. I've got to do my best there, give it my all, and then I'm going to move on to other parts of my life.

MS. KRAMER: I do think that work/life balance does not necessarily just mean 40 hours a week, and then I'm not at work. For example, here, there's a fitness center. We can go during our lunch break and run on the treadmill for 20 minutes and come right back up and go back to work, that
kind of thing, just to where it's almost like you can still maintain other priorities and not -- I love the idea of working hard. I want to work. I think it's almost more of a flexibility kind of deal, even if you are working more hours than 40, instead of just a certain number.

MR. SIMPSON: I'm going to try to keep us on task because I know you guys have a lot of important issues that are going to get put in front of you today. I think we're kind of running up against the end of our time. In an attempt to sort of summarize and relate back to those themes we talked about, in terms of choosing a bank, we heard a lot of trust and establishing relationships. If they can get you in there at three years old, then apparently that's the easiest way to ---

(Laughter.)

MR. SIMPSON: In terms of keeping that relationship, we've heard a lot about convenience. Cost is certainly a factor, sort of the traditional things that we'd hear from any generation.

Technology's obviously very
emphasized. Technology's very important, particularly since the mobility of where you are in your careers and moving around quite a bit, it's important to be able to reach your bank without having to change.

Communication, I heard a lot -- maybe we didn't actually say it, but it sounds like the social impact, your bank might be able to play a role in terms of how active they are in the community. That might be a better way to advertise to you than actually sending something directly to you. But in any event, everybody definitely said that they like being able to reach their bank. You like to be able to reach out to your bank and contact them when they need to. Then in terms of the labor themes, what I got out of it a lot was there's a lot of upward mobility. A lot of is there opportunity to grow in this career? You think that's important. Then, of course, those same themes, in terms of social impact. Everybody seems to like what they see in terms of that, not that it's completely altruistic, but certainly,
you have mission behind us, as well.

I think, again, that's all the time we really have, so I don't want to take up too much of you all's time, but I really appreciate you having us here and allowing us to be involved in this discussion, so thank you.

PARTICIPANT: Thank you guys very much.

CHAIRMAN GRUENBERG: I'd just like to say I have one observation that I found enlightening, which is that you all seem to value technology, the ability to engage with your institution on a remote basis, but at the same time, for most of you, it's also a value that you should have a scale that you can reach and relate to, you have people that you can actually necessarily call on. So to me, actually, I found that interesting and sort of encouraging. I sort of had an assumption that if you're focused on doing your banking online, I sort of had an assumption that the larger institutions could offer a wider array of things, it's almost the smaller institution offers the
basic services online that you need to do your business, they're adding value of also having somebody that you can contact, access, engage with, and that you know is a real value for you. It strikes me that's a combination where the smaller institution can use technology functions to advance its business and the two seem consistent.

MEMBER WILLIAMS: It's great news for us.

MR. SIMPSON: All right, thank you, guys.

(Simultaneous speaking.)

MS. RYAN: We're going to take a 15-minute break now, and we'll regroup at 10:45.

(Whereupon, the above-entitled matter went off the record at 10:31 a.m. and resumed at 10:49 a.m.)

MS. RYAN: Welcome back, everybody. We're now going to have senior staff provide the committee with a brief update on the FDIC's ongoing regulatory review being conducted with the other federal banking agencies, in accordance with the
Economic Growth and Regulatory Paperwork Reduction Act, or EGRPRA. To tell you about the latest developments in the EGRPRA review process, Roberta McInerney, deputy general counsel in our Legal Division, and Ruth Amberg, assistant general counsel in the Legal Division.

They will be joined by Jim Watkins, senior deputy director in the Division of Risk Management Supervision, and Bob Storch, who is our chief accountant. After Roberta and Ruth provide the committee with a general update on the EGRPRA, Jim and Bob are going to tell the committee about a number of related initiatives that are currently underway. So I'll turn it over to Roberta now.

MS. MCINERNEY: Thank you, Barbara. Good morning, everybody. It's great to see all of you here. It's always a really interesting event, and I always learn a lot, so thank you. As Barbara mentioned, I'm delighted to be here. I'm here along with my colleagues, Ruth Amberg, Bob Storch, and Jim Watkins, to provide you with a brief update on where we are in the EGRPRA process. As a very
quick reminder, the EGRPRA statute requires the FDIC, OCC, and Federal Reserve to review our regulations at least once every ten years.

The purpose of the review is to identify any outdated regulations or those that are unnecessary that affect insured depository institutions. We conducted our last EGRPRA review in 2006 and are on target to complete our current review by the end of this year. The agencies began the EGRPRA review in 2014, by publishing the first in a series of four Federal Register notices that requested comments from bankers and other interested parties on our regulations.

The comment period for the fourth and final notice ended this past March. The four notices covered all regulations issued by the agencies through December 31, 2015, so it did allow comment on a number of the Dodd-Frank regulations, as requested by bankers and others. As you know, we organized each regulation according to 12 substantive categories, applications and reporting, powers and activities, international
operations, banking operations, capital, Community Reinvestment Act, consumer protection, directors, officers, and employees, money laundering, rules of procedure, safety and soundness, and securities.

In addition to the Federal Register notices, the agencies held six outreach sessions --- excuse me, six outreach events across the country in the West, the East, in the middle of the country, and with over 1,000 participants attending in person, by telephone, or via live stream. The Kansas City outreach meeting specifically focused on rural and community bank issues.

We heard directly from many individual bankers, as well as from consumer and community groups, regarding their concerns with our regulations. Agencies also received over 250 written comment letters in response to the four federal register notices, and many of them are very detailed, and they're very thoughtful comments, I must say. We are now in the process of really
analyzing those comments, each one of the comments, to prioritize them, to make sure we address all the comment areas and consider all of them and prioritize recommendations and consider appropriate changes that we could make in our regulations. Agencies plan to complete our final EGRPRA report by the end of this year, and then submit it to Congress, as required under the statute. As you know, we haven't waited for the issuance of the final report to take action.

We certainly began to take action in response to some of the comments we received, including some of the discussions we've heard at this committee. For more information about the actions the FDIC has taken so far and is still in the process of taking, and also some of the things we've heard from commenters, I'll turn the session over to Jim Watkins. Jim.

MR. WATKINS: Thank you, Roberta, and good morning. Please allow me to take a moment and touch on a few of the regulatory burden reducing initiatives and actions taken or in the process of
being taken. The FDIC is acting on regulatory relief suggestions throughout the EGRPRA process, and we appreciate the comments that we have received at the outreach sessions and by this group, as well. As a reminder of some of the actions taken so far, we've issued several financial institution letters, for example, relating to the application process. In November of 2014, we released an initial set of questions and answers about the deposit insurance application process to aid applicants in developing proposals for federal deposit insurance, and to enhance transparency of the application process.

In April of this year, we issued an update to these frequently asked questions. The supplemental questions and answers addressed business plan content with respect to initial submissions, kind of addressing some weaknesses that we've identified in other plans, and addresses changes in business plans.

We also previously released a financial
institution letter relating to applications which have significantly streamlined the requirements for applications to conduct permissible activities for certain bank subsidiaries organized as limited liability companies or LLCs. These new procedures are streamlining the process for institutions by requiring far fewer applications, and in the cases where it's necessary to file an application, most of those decisions now are being made at our regional offices. In April of this year, the FDIC announced the rescission of a prior financial institution letter titled, "Enhanced Supervisory Procedures for Newly Insured FDIC Supervised Depository Institutions," which basically eliminated the enhanced supervision and reporting requirements for institutions in the years four through seven that were viewed as de novo institutions.

The de novo period, now, for institutions, is reverted back to the original and customary three-year term. In addition, the FDIC announced subject-matter experts that we have
placed and designated in each of our regional
offices to serve as points of contact for deposit
insurance application.

The FDIC remains committed to working
with groups interested in organizing community
banks. To that end, we are developing additional
resource materials, as suggested by Director
Doreen Eberley this morning, to guide applicants
through the application process. We’re also
planning outreach meetings with the banking
industry and participants, organizing groups and
such, to ensure that industry participants are very
well informed about the FDIC's application
approval process, as well as available tools and
resources that we have issued in this regard.

For example, such tools include a
series of educational videos categorized often as
technical assistance, new directors' education,
and virtual directors' colleges produced by the
FDIC and available on our website under the
directors' resource center page.

These series are designed to provide
useful information to bank directors, officers, employees on regulatory issues and proposed regulatory changes and include over 25 available videos, with topics ranging from operational areas to cybersecurity and our examination process.

If you have previously reviewed the community bank corporate governance video, you may want to re-review it again because we've just come out with an update, as you suggested earlier this morning. One last change I wish to mention has to do with the examination cycle. Upon authorization provided under the FAST Act, the banking agencies moved quickly to make an 18-month examination cycle available to more community financial institutions by increasing the eligibility threshold for qualifying institutions from $500 million in total assets to $1 billion in total assets.

That's very positive news for many of you. Now, to continue our discussion on FDIC initiatives and the work that's being performed in that regard, let me turn the mic over to our chief accountant, Bob Storch, who will talk about call
report changes.

MR. STORCH: Thank you, Jim. Good morning. The FDIC and the other banking agencies are continuing to move forward with the FFIEC's Community Bank Call Report Burden Reduction Initiative. I spoke to this committee in July of last year about the five action areas that comprise this inter-agency initiative.

The areas that may be of most interest to you this morning are those where you can, or will soon, see some concrete steps being taken to reduce call report burden. One action area where the agencies are in the final stage is the implementation of an initial small number of burden-reducing changes to the call report. These burden-reducing changes were issued as part of a proposal in September of 2015 that also included some other revisions to the call report that generally should have a limited impact on community banks. After considering the comments and the proposal, the FFIEC and the banking agencies recently finalized these provisions.
On July 1st, the FFIEC sent a financial institution letter to all institutions outlining these final call report changes and when they would take effect. Most of the burden-reducing changes and some other revisions take effect September 30th of this year, with the remaining changes taking effect in March of 2017.

Drafts of the revised reporting forms and instructions for these changes were posted on the FFIEC's website in early July. The July 1st financial institution letter also addressed another action item under the Burden Reduction Initiative, which is the agencies' consideration of the feasibility of introducing a streamlined call report for small institutions. At last December's examination council meeting, the FFIEC's task force on reports discussed several options for the possible design of a less-burdensome call report for small institutions and other call report streamlining methods.

The agencies gained insight on the burdensome aspects of the call report preparation
process from on-site visits to nine community institutions during the third quarter of 2015, and through a number of conference call meetings with small groups of community bankers earlier this year that were organized by the Independent Community Bankers of America and the American Bankers Association.

During the visits to banks and during these conference call meetings, community bankers explained how they prepared their call reports, identified which schedules or data items take a significant amount of time or manual processes to complete, and described the reasons for these challenges in call report preparation.

The bankers also offered suggestions for streamlining the call report. The constructive banker feedback about call report burden and these options from the task force's community banker outreach activities have helped the agencies develop a specific call report streamlining proposal for small institutions. The proposal is now being reviewed by senior
leadership of the FFIEC's member entities. The FFIEC and the agencies anticipate publishing this proposal within the coming months. We believe it should meaningfully expand the burden-reducing changes to the call report well beyond those included in the September 2015 proposal.

Once that proposal is published, we certainly encourage you and invite you to share your comments on the proposal and the industry's comments, as a whole. We'll look forward to receiving to try to move forward to implement a streamlined call report for smaller banks. Thank you. Roberta or Barbara, we can turn it back to you for questions and discussion.

MS. RYAN: Okay, any comments or questions from the committee, reactions?

MEMBER BLANKENSHIP: I just want to say thank you because for our shop, there is quite a bit of manual effort that goes into that. That would free up -- unfortunately, it's the key people in accounting and in the loan department that seem to be particularly burdened. It's always at
quarter end and a busy time for banks, so thank you for any relief that you could give us in that area.

MEMBER WILLIAMS: Overall, I think the effort in this process was very evident to the bankers, that you guys were very serious about actually taking a look at this and doing what you could to help streamline the process and help us in any way you can. That's appreciated.

MS. RYAN: Okay, great. Thank you, Roberta, Ruth, Jim, and Bob. Now, we're going to turn to our next panel. We thought we would provide the committee with an update on some consumer compliance issues, particularly recent proposed changes to the Consumer Compliance Rating System for banks.

To lead us in this discussion, we're going to have Jonathan Miller, deputy director in our Division of Depositor and Consumer Protection, and Luke Brown, associate director in our Division of Depositor and Consumer Protection, as well as Faye Murphy, who is a colleague of Jonathan and Luke's. At this point, I guess I'll turn it over
to Jonathan.

MR. MILLER: Thanks, Barbara. Good morning, everybody, although I'm mindful of the fact that we're the last panel before lunch. It's always a dangerous position to be in. I've asked Luke and Faye to prepare a presentation on the new compliance ratings proposal.

If we have some time after that, I may talk briefly, also, about the new CRA guidance that was just put out recently, and maybe a couple of other things, but this will probably be the focus most of the panel, so Luke, go ahead.

MR. BROWN: Good afternoon, everybody. Happy to be here. On May 3, 2016, the member agencies of the FFIEC released a proposal for updating the inter-agency Consumer Compliance Rating System. Just as a reminder, the FFIEC is made up of the Federal Reserve Board, the FDIC, CFPB, OCC, NCUA, as well as representatives from the state banking agencies. I just want to highlight that because this is something that we all collectively worked on, in terms of consistent
guidance across the agencies, which I think will be helpful to the institutions going forward. The rating system is used by examiners to evaluate financial institutions' adherence to consumer compliance laws and regulations. Based on the ratings framework, examiners assign a consumer compliance rating to each institution, as you're well aware. The main purpose of the rating system is to ensure that supervisory institutions are evaluated by the FFIEC agencies in a comprehensive and consistent manner.

The goal is also to ensure that supervisory resources are appropriately focused on areas exhibiting risk and on institutions that warrant elevated supervisory attention. The public comment period ended not too long ago in July, July 5th. We received 17 public comments, which we're looking at very closely. We look to hopefully receive some comments that will improve the guidance.

Today, Faye and I are going to briefly describe the proposal, as well as related
background information. But I do note that because this is a proposal, and the agencies are going through the public comments and looking for input through those comments, I think it's premature to have a conversation about what the final guidance might look like as we work through this. However, during this discussion, we welcome any feedback you might have, and we will certainly include that feedback in our process, going forward, as we work with the other agencies. In your packet, you might have a copy -- I shouldn't say might.

I'm sure you have a copy of the proposal, if you want to look at it. I think particularly during Faye's portion of the conversation, there's a table in the back that is essentially is the framework and the meat of the proposal. The existing rating system that's in place now has been in place for some years.

It was adopted by the FFIEC when examinations focused more on transactional testing, sort of the more rule-based approach for
regulatory compliance, rather than evaluating the sufficiency of an institution's management of risks generally to ensure compliance. In May, when the proposal was released, the proposal was released in recognition of all the significant changes that have taken place over the years. As you are well aware, regulatory changes, supervisory changes, market changes, there was no CFPB when these were issued. We thought it was important to revisit the guidance and take a look at it very closely. We also, over the years, have received requests from the industry to update the compliance rating, so that was also front of mind for us. The revisions are designed to more fully align the rating system with the FFIEC agencies' current risk-based approaches and our tailored examination approaches.

The proposed revisions were not developed to set new or higher supervisory expectations. Essentially, they're consistent with the way we've been examining for some time, so they should represent no additional regulatory
burden. Since the existing ratings were issued, each of the agencies has adopted a risk-based consumer compliance examination approach.

As you know, risk-based consumer compliance supervision evaluates whether an institution's compliance management system effectively manages the compliance risk at an institution. Under this supervisory approach, examiners tailor supervisory activities to each institution and adjust these activities over time. The revisions proposed in May would more fully align the ratings system with the FFIEC agencies' current examination approaches in a number of ways. For example, the proposed revisions emphasize the importance of institutions' compliance management systems, in particular, risk-controlled processes designed to manage risks in the products and services offered to bank customers.

Another objective is to develop a rating system appropriate for evaluating institutions of all size. This is a really important tenet for us, as we examine community
banks. Consequently, each oversight factor in the proposal places an emphasis on examiners evaluating the institution commensurate with its size, complexity, and risk profile. That's very important, and it's noted throughout, as you'll see when we look at the proposal.

Also, a new rating system would establish incentives for institutions to promote consumer compliance by creating a framework for recognizing when a bank is preventing or self-identifying or addressing compliance issues in a very proactive manner. We thought that was also an important priority. In addition, the proposal would promote coordination among the agencies. Each of the agencies would import and use the same rating system to apply to their institution, so it would be a consistent standard across all institutions, whether bank or non-bank. With that, that's my overview of the proposal. I'm going to ask Faye to go into a little more detail and talk about the components and the structure of the rating system.
MS. MURPHY: Thanks, Luke. The proposal retains the current five-scale framework for the proposed Consumer Compliance Rating System. A one represents the highest rating and, consequently, the lowest degree of supervisory concern, while five represents the lowest rating and the most critically deficient level of performance and, therefore, the highest degree of supervisory concern.

As Luke mentioned, the proposed rating system reflects risk-based expectations commensurate with the size, complexity and risk profile of institutions and incents institutions to prevent, self-identify, and address compliance issues. Each institution would be assigned a consumer compliance rating based primarily on the adequacy of its CMS, which is designed to ensure compliance on a continuing basis. The agencies are proposing a rating system that includes three categories of assessment factors, board and management oversight, compliance program, and violations of laws and consumer harm.
When assigning a rating under the proposed rating system, the examiners will consider each of the assessment factors in each category. There are a total of 12. The three categories allow examiners to distinguish between varying levels of supervisory concern when rating institutions for compliance with federal consumer protection laws. The consumer compliance rating should reflect a comprehensive evaluation of the institution's performance.

It is not based on a numeric average or any other quantitative calculation. Specific numeric ratings will not be assigned to any of the 12 assessment factors. It is important to stress that all institutions, regardless of size, should maintain an effective CMS. The sophistication and formality of the CMS typically will increase, commensurate with the size, complexity, and risk profile of the institution. It is also important to note that the articulation of CMS assessment factors is not intended to create new expectations for lower-risk institutions. Now, I'll briefly
describe the rating system category and the
assessment factors.

The first category of the proposed rating system, board and management oversight, will be used to analyze the institution's CMS and the role of its board and management officials. The four assessment factors in this category would be oversight and commitment, which would measure the overall institution's compliance risk management program.

There's change management. This is where we measure the effectiveness of the institution's change management processes, including responding timely and satisfactorily to any variety of change, internal or external, to the institution.

There's comprehension identification and management of risk, which would arise from the institution's product services or activities, and then also under this category, there's corrective action and self-identification, where you're looking at corrective action undertaken as
consumer compliance issues are identified. Compliance expectations contained within this category extends to third-party relationships, into which the financial institution has entered. Examiners should evaluate activities conducted through the third-party relationships as though the activities were performed by the institution, itself.

The agencies believe the above factors will provide examiners with an effective and consistent framework for evaluating whether or not board and management are engaged to a satisfactory degree at a particular institution. All institutions, regardless of size, should maintain an effective CMS.

However, each institution should be evaluated based on its size, complexity, and risk profile. You'll notice that we're going to keep mentioning that. The second category, compliance program, would be used to analyze other elements of an effective CMS. The assessment factors for a compliance program are policies and
procedures -- here's where we look at whether the institution's policies and procedures are appropriate to the risk in the products, services, and activities of the institution. The next assessment factor is training. Here's where we look at the degree to which compliance training is current and tailored to risk and staff responsibilities. Also, we'd look at monitoring and/or audit.

Here's where we look at the sufficiency of the monitoring and, if applicable, audit to encompass compliance risks throughout the institution. Finally, in this category, there's the consumer complaint response. Here's where we look at the responsiveness and effectiveness of the consumer complaint resolution process. Examiners should also review a financial institution's management of third-party relationships and services as part of its overall compliance program.

The agencies believe these factors, along with board and management oversight, will provide an effective and consistent framework to
evaluate an institution's CMS. Each of these assessment factors will be considered in evaluating risk and assigning a consumer compliance rating. As previously mentioned, each institution would be evaluated based on its size, complexity, or risk profile. Next time, I'll have you all say it with me. The third category, violations and consumer harm, will provide examiners with a framework for considering the broad range of violations of consumer protection laws and evidence of consumer harm. Consumer harm may occur as a result of a violation of law.

While many instances of consumer harm can be quantified as a dollar amount associated with financial loss, such as charging higher fees for a product than was initially disclosed, consumer harm may also result from a denial of an opportunity. In conjunction with assessing an institution's CMS, based on the first two categories, examiners will evaluate the consumer protection violations, if any, and related consumer harm, based on the following four
assessment factors.

The root cause assessment factor analyzes the degree to which weaknesses in the CMS gave rise to the violations. The severity assessment factor weighs the type of consumer harm, if any, that resulted from violations of law. The duration assessment factor describes the length of time over which violations occurred, and the pervasiveness assessment factor evaluates the extent of the violations and resulting consumer harm, if any. Examiners are directed to consider all violations of consumer law, based on the root cause severity, duration and pervasiveness of the violation.

This approach emphasizes the importance of a range of consumer protection laws and is intended to reflect a broad array of risks in the market and the potential harm caused by consumer protection-related violations. In conclusion, we want to emphasize that the agencies believe that self-identification and prompt correction of violation of law reflect strength in...
an institution's CMS.

We want to emphasize that a robust CMS, appropriate for the size, complexity, and risk profile of an institution's business often will prevent violations or will facilitate early detection of potential violations. This early detection can limit the size and scope of consumer harm. We also want to emphasize that prompt self-reporting of serious violations represent concrete evidence of an institution's commitment to responsibly address underlying risks. In addition, appropriate corrective action, including both corrections of programmatic weaknesses and full redress for injured parties limits consumer harm and prevents violations from occurring in the future.

Finally, we want to emphasize that the intent of the proposed Consumer Compliance Rating System is to recognize institutions that consistently adopt the strategies that I just previously discussed. With that, I'm going to turn it over to Jonathan.
MR. MILLER: I think maybe we can have a little bit of a discussion on this proposal since there's a lot to digest here. You may have a lot of questions. I do want to underscore, I think, the message that we're trying to give both externally, to the bankers -- and this is, again, on an inter-agency basis -- and internally, to our examiners is we believe that these changes make the ratings -- catch the rating system up with the process we actually use. We're not really expecting changes in our ratings, but the old ratings which, again, as Luke mentioned, were last done in 1980, just didn't really -- just were not really matching with the process we were using. That's our fundamental message point, but it's a significantly new system, so I know there may be a lot of questions. Let me open it up.

MEMBER BRYANT: I thought I needed to get this in. I think this is a great improvement. One of the items that I got a chance to read, looking at Pages 20-23, mentioned something about a violation of law or having major problems, not
necessarily keeping the institution from receiving a 1 or a 2 compliance. The area that I think is extremely helpful for institutions is the area of corrective action and self-identification.

Without having a chance to read through all of it, corrective action, self-identification, I would assume would also include having compliance committees comment on this include information that's shared with board members, so that when there's a Safety & Soundness examination, the examiners will be able to go and look at minutes to see that the board has seen that there have been compliance issues or it's a violation of law, and that it was properly identified and pointed to the board and corrective action taken, correct?

MR. BROWN: Obviously, there's a number of ways, whether it's through the monitoring or audit or reports. If an issue is identified and you resolve that issue, that's something that we like to see when we come in for a formal examination. There's no express mention of that in the current, existing rating system, so we
wanted to make sure we outlined that very specifically in the proposal, so that people could get credit when they self-identify appropriately.

MR. MILLER: There's a helpful -- I saw it on Page 24. There's a helpful chart. I think right in the very first box there, under the board and management oversight assessment factor, for a one rating, examiners will evaluate if board and management demonstrate strong commitment and oversight of the financial institution's compliance system, so exactly what you said, evidence of that active participation by the board is important.

MEMBER WILLIAMS: I know we talked about not getting into the details about what the final will look like, but as it's proposed, I'm assuming there's effectively three component ratings and an overall composite rating?

MR. BROWN: That is not correct. Every institution's business, essentially, is different, obviously. You could have a focus on mortgages or credit cards. Every time you go to
an examination, you're looking at it from a risk-based perspective.

As opposed to a component rating that would be stagnant and applied consistently every time, we think it's important for an examiner to use their judgment. So to the extent that board and management involvement, in terms of good things or negative things, is considered consistent with what's going on at that institution.

If you had a component rating and it equally was weighted across this whole area, that would not work for all institutions. We want to be able to give people credit for where they're doing well and emphasize that when we're doing an assessment.

MEMBER WILLIAMS: So no --

(Simultaneous speaking.)

MR. BROWN: It's just an overall.

MEMBER WILLIAMS: Just an overall, okay. I was under the impression there would not be individual ratings for -- I'm sure appreciative of that fact, that for rate 12 categories, so it
would just be the overall composite?

MR. BROWN: That's right, but all examiners will consistently think through those 12 components. That's what's important.

MR. MILLER: Any other comments?

MEMBER HASKIN: I would just say that we have just had waves and waves of new consumer regulations put upon us, and some of those have not had very large windows to train and educate, and even to acquire software to be prepared. And so I would just say that we find ourselves constantly reviewing to make sure we're doing things right these days, and even though we think we're prepared, sometimes we don't know what we don't know until we actually do a loan.

So I would hope that in this time of new regulations that the examiners would be mindful of that. That banks are really trying to do the right thing, but it's sometimes difficult to comply to the letter. Especially the mortgage rules. We're struggling. We keep sending people to schools and quite honestly, a lot of the training
we receive we're getting different messages, conflicting messages, as this process of actually preparing loans and using these new regulations as they're implemented, finding out those differences and what applies. So I would just pray that you be mindful of that.

I know that we spend a tremendous amount of time in our bank trying to be correct on compliance issues, but we have just really been struggling to make sure that we're doing everything correctly.

MEMBER WILLIAMS: I would just add, too, especially in light of -- when you start talking about time frames, that's probably been the biggest issue for us, as far as some of the mortgage regulations. While I understand that the FDIC is not writing this, you're regulating it.

There's that fine balance for us between taking care of our customers and doing it the right way. I'm sure some of the other bankers have seen this, but we've seen a great deal of customer response saying we trust you. We don't
need four days to look over this document.

Our response is don't care, you've got to take it. You can't have your money until this -- those are the kind of things -- the hoops that have been hardest for us to jump through. Again, I would just echo Jane's comments. Be patient with us as we try to get through this process.

MR. BROWN: I just want to mention we've been in touch with our examiners, and we stay in touch on what's happening on the ground, in terms of issues that you're seeing and challenges you're having. We did issue a financial institutions letter last fall, which says we're mindful of all the changes, and we're keeping that in mind as we examine.

MEMBER WILLIAMS: We saw that in the process of our exam. I agree. It's a slower process than we had hoped it would be trying to get on top of all this, and it keeps changing. That's the problem.

MEMBER BLANKENSHIP: Just to kind of
touch on that, as well, just with the new TRID disclosures and the title companies and everyone's interpretation being just a little bit different, we're seeing more than ever that the consumers are actually being harmed by this.

Because you have a closing set on Friday, movers lined up. They've brought the dog, the cat, kids, and then they can't close because it's one little line, and everyone is so paranoid about changing anything before they get 14 stamps of approval that it really is creating a lot of delays, at least in our experience, for that consumer.

MR. MILLER: When the first set of mortgage rules went into place in the run up to that in 2013, they went into place in 2014, we took the position that what we were -- we would not expect for our banks to have everything absolutely perfect. We were going to look for efforts by the bank to get in compliance, actively to get into compliance, an understanding of the requirements and so forth.
That's the position we took with the first set of rules. We took exactly the same position with TRID, what the CFPB calls know before you owe, the combined TILA-RESPA disclosures, as Luke just outlined. We've actually pulled our examiners and have found that for the most part, the banks are doing that.

We're finding some violations, where we're noting the violations where we find them, just to have a record, but without really any consequence, as long as, again, the bank is pursuing the effort to get into compliance. Even the violations we saw were not particularly significant. From our experience, I think we're seeing a nice path towards compliance among our institutions.

MEMBER HASKIN: One other thing I'll mention is the reference material for lenders to use is very complicated. It refers to sections of the code. It's not user friendly. And a lot of our people have tried to research that to understand exactly how we need to disclose, and
it's very difficult to use the information that's out there as a user to know how to do the documents, because it refers a lot to the code. I believe that's the CFPB's code.

   MR. MILLER: Right, they have --

   MEMBER HASKIN: So I don't know if that's something that all the agencies can work on, but our people do try to research those things, and that's one of the things that my documentation preparers have told me, is that it's very, very hard to get any guidance from that documentation.

   MR. MILLER: The CFPB has put out a lot of educational material

   (Simultaneous speaking.)

   MEMBER HASKIN: There is material out there, pieces out there, but they all reference codes. It's so cryptic that we can't discern how we're supposed to use it. It's very cryptic referring to the code.

   MR. MILLER: That's a helpful comment, and we can pass that along. Any other --

   MEMBER LUNDY: Since this is my last
meeting on the committee, I'll throw something out that I threw out probably at my first meeting. I throw this out for a suggestion for the kind of research that I know you all committed to do. I'm from a western state -- there are nine community property states. Each one of them has a slightly different variance on it. Sometimes, those community property laws, which were forward looking at the time, in terms of equal ownership of property, and are generally forward looking, and in some ways, equal opportunity credit laws passed two generations later caught up with the same thing.

But for our frequent instances where the specifics of those community property laws were in variance with technical interpretations of equal opportunity, and there's some confusion about that. The thing that comes up most often is called the spousal joinder issue. It's whether and when a spouse, who may have separate property and may not be directly involved in a business, it's appropriate to either have that spouse join in the
guaranty, or whether and how the financial
institution analyzes property.

This is not the appropriate time to get
into all the nuances, but it is a nuance they
complicated -- and different because California
and Arizona and Nevada and Washington all have
slightly different variations on the theme. So I
would just suggest, as a future item, that jointly,
you all could get on that and work on it and try
to come up with a common roadmap, where there are
differences in state law that has to -- that's, I
think, probably the reason that it's been difficult
to try to get a common roadmap because those
differences make it difficult.

At any rate, I think that's an area that
can cause some confusion. Ironically, the one
area where all the potential violations of
requiring a guaranty when you shouldn't have go out
the window for SBA on this one. Small Business
Administration absolutely requires both spouses to
sign, no matter the source of their personal
property, the ownership source.
At any rate, I don't have a specific suggestion, other than it can be an ongoing irritant, and sometimes a major issue in a compliance exam. I just throw that out as a suggestion for future work.

MEMBER WILLIAMS: I'll make one last comment. It's one I probably made before. I think having just gone through a compliance exam, this rating system matches up much better to what the examiners did and how they looked at the bank. While somebody made reference earlier today to the fact that the pre-exam questionnaire is much lengthier than it was, in fact, I think our folks said, "I think we got more than one copy." I said, "No, I think this is it." It took quite a bit of time to get that information in, but it was done -- that information was used well up front. The amount of time in the bank was limited. The results were great. It's the right path, at least all the folks that I've talked to that have been through exams, my counterparts, recently, that experience has been very positive.
That's very much a step in the right direction.
Thank you.

MEMBER SCULLY: I just have a clarifying question, which is that presumably all harm is deemed a subset of a violation, just a claim of harm, but without it being a violation --

MR. MILLER: Right. You wouldn't just have a claim -- a claim of harm is not sufficient --

MEMBER SCULLY: We all know we get claims of harm --

(Simultaneous speaking.)

MR. MILLER: Right, and that may not -- we have a complaint line, a consumer response center. We get a lot of calls there. We track down those. If there is a problem -- it's actually a good source of intelligence for us. If there is a problem it's very helpful, but it often turns out not to be a problem at all.

MEMBER SCULLY: And specifically not to be a violation.

MR. MILLER: Well right. If it's not a violation then yes. Anything else?
MEMBER BRYANT: You will be around for a few minutes, right?

MR. MILLER: We will.

MR. BROWN: Longer than that if you need it.

MR. MILLER: I'll just quickly cover -- just recently, we released a second set of Community Reinvestment Act questions and answers. These have been outstanding for quite a while. We've been working with the OCC and the fed to finalize them, to update some of the guides for the CRA. They were finalized just last week, as a matter of fact. Basically, they're additional guidance in a number of areas. Availability and effectiveness of retail banking services is one of the areas we put out some additional guidance, innovative and flexible lending practices.

Just as an aside, because of a meeting I had yesterday with Jim and a colleague that he brought in, one of the things that we look for in CRA as sort of a plus is if a bank does something innovative to serve the low and moderate income
community in its assessment area.

Jim brought in a person that's doing an IDA account. It's an individual development account to help low and moderate income people for college education. It's quite an intensive account management process. Even if other institutions in an area provide a service, if it's new to that institution, we will consider it innovative.

In fact, in that case, I don't think there are many other institutions -- of kinds we look for. It includes some community development related issues, including economic development, community development loans and activities, and revitalize or stabilize underserved non-metro middle income geographies and community development services. It's a nice set of helpful guidance that will help your institutions figure out better ways to serve your communities.

MEMBER SCULLY: It's a lengthy document, but I commend you for at least trying on the community development I think it's always
difficult to determine is this really needed development or not.

     MR. MILLER: Two areas that might just be worth calling out is investment in broadband infrastructure, which is going to be increasingly important for community, as a whole, as long as it includes low and moderate income segments. That's, I think, going to be particularly important as we talk to the millennials and the importance of technology to them, so having community banks have access to high-speed Internet. Then energy efficiency, as well, is another area that we've sort of elevated for community development.

     MEMBER SCULLY: But they both have to be directed at --

     MR. MILLER: Include, yes, correct. If it's a small community and you're providing access to the whole community, you'd get credit for that. You couldn't cut out the low and moderate income. Thank you.

     MS. RYAN: Okay, thanks, Jonathan, Luke, and Faye. Right now, we're going to take a
break for lunch. We'll reconvene at 1:00. So all of the committee members and senior FDIC staff are welcome to join us upstairs. Thanks.

(Whereupon, the above-entitled matter went off the record at 11:40 a.m. and resumed at 1:09 p.m.)

MS. RYAN: Welcome back, everybody. We're now going to focus on financial technology, or what is called fintech issues. We have senior staff from our Division of Risk Management Supervision and Division of Depositor and Consumer Protection, I think most of whom you've already heard from today, except, I believe, Rae-Ann Miller is new with us today. She's associate director with the Division of Risk Management Supervision. With that, I'll turn it over to Doreen.

MS. EBERLEY: I'm going to quickly turn it over to Jim. Mark and I have strategically placed ourselves on the other end of the speakers. Jim, if you can kick us off.

MR. WATKINS: Thank you, Doreen, thank you, Mark, and good afternoon. The FDIC
continually monitors emerging issues, emerging trends for financial institutions and really, the financial industry as a whole. Financial technology or fintech is one of those emerging issues that we are exploring and looking at.

It is becoming a rather significant and important topic for the banking industry. It is also important for the FDIC and for community bankers. We'd like to spend some time with you this afternoon discussing this matter and solicit your feedback, your insights, your comments. We have a brief slide deck. We have eight slides that we'd like to walk through, and then kind of open it up for a broader discussion.

If I could turn your attention to the second slide, which is FDIC's fintech steering committee and the objectives of our steering committee. Let me begin by noting that the FDIC has formed a fintech steering committee, which is comprised of FDIC executives from supervision, from compliance and consumer protection, from our insurance and research areas. It also includes
representation from our Office of the Chief Risk Officer, and also our Legal Division, as well. The objectives of the steering committee are outlined here.

Basically, it's to gain an understanding and assess, monitor, if you will, fintech activities, developments, and trends, understand in greater detail what is occurring in the market and what may be occurring in the market, evaluate the impacts to our organization and our stakeholders, banking, especially community banking, the deposit insurance structure. Supervision and oversight would be included in that, as well as economic inclusion, and consumer protection.

Also, the steering committee objective would be to oversee our internal working groups that the FDIC has formed relating to fintech. We will talk a little bit more on that topic in the next couple of slides that follow. But essentially, we have a staff that is actively researching and gaining an understanding and
insights into the fintech area and its multiple aspects relating to banking. Then the steering committee may end up making recommendations for follow-up action and monitor any implementation of those recommendations.

Then finally, it is to help formulate potential strategies to respond to opportunities and challenges presented by fintech to ensure developments align with our regulatory objectives and goals. The idea here is that as this area evolves, we want to make sure that we understand it and are prepared for it and how it would affect our jobs. Now, I will turn the next slide over to Rae-Ann Miller.

MS. MILLER: Thanks, Jim. As we talk through fintech just amongst ourselves, with our colleagues at the other agencies and other stakeholders that come in and visit with us, we start with what is it. I think there's some debate there. This definition here -- I'm not going to read it; you can read it yourself -- it's from the Financial Stability Board. Broadly here, when we
talk about it, we look at fintech as the use of
technology in an attempt to make financial services
more efficient. In this regard, it's nothing new.
You folks look for ways to improve efficiencies,
I would assume, in your jobs. Under this
definition, ATMs probably would have been fintech
at one point, but I can't remember a time when we
didn't have them.

In some respects, fintech is viewed as
a potential to existing financial services, that's
the whole disruption theory. That part is more of
a customer service dimension, but there's a whole
other area of fintech that has to do with trying
to improve efficiencies in the back office space.
Slide 4, I wanted to just expand a little bit more
about what we look at, in terms of the dimensions
of fintech.

Obviously, there are fintech companies
and processes that develop credit products. We
talked to this committee a few meetings ago about
marketplace lending. It's probably the most
visible example in the credit space, but we also
look at crowd funding in this group. There are other credit products in this segment that are emerging, as well. There's also companies that specialize in offering deposit accounts without brick and mortar. We heard the folks today. One guy didn't go into a bank for two years. There are companies, mostly partnering with banks, at this point, that just offer deposit-gathering services. Then within the payment sphere, there's a number of person-to-person payment systems, international payment transfer and currency exchanges. Some of our millennials that work here, not the ones that were up, but other ones, will Venmo you.

I'll Venmo you later, if you go out to lunch. That's paying each other. I had to be told what that was, but that's what that is. In terms of investment management and personal finance, there's companies and applications that aggregate accounts. People know those. I think, again, one of the millennials actually talked about using one of those.
There's investment allocation packages, and even high-frequency trading we view as coming in this area. Then the back office processing covers things like distributed ledger technology that you may have heard about and smart contracts. Then under the capital markets, when we're talking about that, we look at companies and services that facilitate, basically, trading, settlement and even security valuation services.

Moving to Slide 5, this is sort of a list of our views of benefits to fintech. Again, I'm not going to read them all. You can see them here. But at its core, the technological innovation tends to promise speed, cost reduction and a better customer experience.

With fintech, and especially with some of the companies that deal with deposit and credit products, they talk about increasing access to the banking system, as well. It may be in a different way, but a lot of the things that you folks do, as well.

From our perspective -- this might be
one you haven't thought about, but from our perspective, in supervising, insuring and resolving institutions, there might be certain fintech advancements that could allow quicker access to information we need to do our jobs. In that way, maybe we could do our jobs in a less intrusive way, as well. I'll turn it over to Jon.

MR. MILLER: If you look at Slide 6, of course, like anything new, there are also challenges and risks. For our banks, when they enter into any new product, service or third-party relationship, whether that's fintech or any other, they need to identify and understand the associated risks and then manage and mitigate those risks. Depending on the activities and business model of the fintech company, risks presented by fintech are similar to those faced by your banks and others, but there may be heightened risks.

For example, if it's a technology-focused service, then obviously cyber issues, IT area, because of the reliance on the technology may be a particular risk to be aware of.
Also, some of these firms rely very heavily on sophisticated models, underwriting models, and they so far have been untested under stress conditions, or may, if not properly monitored, pose fair lending risk.

Other challenges include disintermediation, or the so-called disruption of traditional banks Rae-Ann mentioned, and perhaps even disruption of their service providers. We added to the list, as a challenge, changes in capital markets processing, given the breadth of those markets and the size and number of the participants that could be affected by wholesale changes there. If you turn to Slide 7, I want to talk a little bit about our ongoing efforts. Jim mentioned that we've recently created a steering committee. This is how we're really addressing following the fintech trends here at the FDIC. We've put together two inter-divisional working groups, split between the wholesale and the retail aspects of fintech.

The wholesale focuses on repos,
derivatives, clearing, central counterparties and credit. The retail focuses on consumer and small business aspects of fintech. The retail group follows trends in marketplace lending -- Rae-Ann mentioned, we've talked about that -- alternative scoring systems which we are starting to hear more about, mobile and virtual deposit services, account aggregators and person-to-person payments.

The wholesale group monitors distributed ledger technology, smart contracts, as well as the development of virtual and alternative currencies. We also have frequent interactions with interested stakeholders. For example, we'll meet with companies that offer fintech products and services, and attend and participate in conferences. Those kinds of meetings are really an important source of information for us, and we learn a lot by those.

Our final slide, Slide 8. On an ongoing basis, we have a number of ways we monitor and respond to innovation, starting with the
committee here, the community bank advisory committee. We also do a lot of work around increasing access to mainstream financial services.

A lot of that has to do with innovation, and particularly technological innovation. For example, we have another advisory committee called the Advisory Committee on Economic Inclusion or ComE-IN, as we call it. We're spending a lot of time exploring the use of technological innovations to bring the un-banked and under-banked into the financial mainstream.

This work, right now, is focused on the use of mobile financial technology to achieve this goal. In fact, we had some of our research staff make a presentation to this committee at the last meeting on that work. There's also the Alliance for Economic Inclusion and Bank-On Movement, which are coalitions of financial institutions, community-based organizations, local governments and other partners that are really focusing on, really, a large number of communities around the
country. Again, their focus is to get people into mainstream financial services, again, thinking about the use of technology to achieve that goal. Just this May, we issued a request for comment. That's our Financial Institution Letter 32-2016, for those of you keeping score at home.

That request is on mobile financial service strategies and how they can be leveraged to improve economic inclusion. In fact, we're looking for bank partners who may want to work with us to demonstrate the effectiveness of mobile financial services in bringing and keeping the underserved in the banking system.

Every other year, we do a survey conducted with the U.S. Census to collect data on the number of U.S. households that are un-banked and under-banked, their demographic characteristics, and the reasons that they are un-banked and under-banked. We've learned an awful lot from that study. Each year, we get to change the questions a little bit and get a deeper and more nuanced understanding. That study will
be presented to ComeE-IN, the Advisory Committee on Economic Inclusion in October.

Finally, we monitor and address issues related to fintech through our regular examination process. That concludes our formal presentation, but we would really be interested in your views on the developments we're seeing in the marketplace and how the FDIC should be focusing its resources as we continue our efforts to monitor and stay on top of this issue.

MEMBER SELESKI: Have we thought about looking -- some of these things are very additive to what we do, in terms of banks and services we offer our clients, but there's also a threat from non-banks eating into our traditional profit areas. I'll give you a few examples. Obviously, consumer lending, now, that seems to -- community banks really aren't involved with that anymore.

It's pretty much of an online, shop for the best rate, whether it's Quicken Loans -- I heard, for instance, that Quicken Loans, I think, does one out of every four home mortgages online
now. Then on top of that, when you look at such things as -- you've got these same-day ACH for a dime. You can do it for ten cents versus sending a wire for $15. Our bank has grown a lot. Our wire volume has stayed consistent. I think it might be useful to see, also, how these non-bank -- or how some of these applications are actually going to hurt the earnings of banks, to some degree. I do think it's going to -- I believe it's probably the biggest threat.

We can talk about regulatory and all these other things. I think these non-banks, these fintech-type opportunities are going to be the biggest threat to especially community banks going forward. I think you mentioned it. I'm stealing your thunder. Three years ago, if you said that. I was half asleep up here. I thought, you're crazy, when you were talking about it, but now I agree 100 percent with you.

MR. PEARCE: Just one of the things that we have been monitoring and seeing is some of the non-bank fintech companies are really looking
for that opportunity where they see there's a particular aspect of a banking process that they can try to disrupt, like remittance or wire transfers is an area where I think some of the non-bank technology companies have really said there's a different way to do that, which really, I think, does pose a risk of putting pressure on revenue at some institutions that are relying on those services.

MEMBER BLANKENSHIP: The other thing that we were discussing -- maybe I'll just steal some of your thunder, but we have to really be concerned about where the end liability lies. When you start looking at some of these ways to make these payments -- and I do think that is going forward because just the way you move money around is becoming such a hot technology commodity, but where is the end liability -- you still have to get -- that money has to end up at a bank somewhere.

I think we really need to look at are we going to be left holding the bag if there's an issue? You see all this, and my millennials use
these payments that I've never heard of. They
don't really think about where that track goes, but
what if it ends up at our bank and we never even
knew -- it's so far removed, we never even knew it,
but the end liability comes back to us. That's
something that I think we really need to look at,
as well. Maybe you need some regulation from CFPB
or something. There's got to be a standard.

MEMBER SCULLY: I think Rae-Ann did a
great job of explaining why this isn't going to go
away: because it's relevant. It's relevant to
consumers and small businesses. Probably like
everybody else at this table, what I worry about
is how do we participate in that.

I, personally, think we're, in the long
run, less threatened by the lending models because
I think ultimately, they're all funded by equity
right now. You can't run a lending business
without leverage. They're going to end up coming
back to us, and some of them already are, either
by trying to sell us what they've originated, or
by borrowing directly from us.
But it's the payment systems that I think are the scariest. The consumers are all obsessed with the front-end applications, and why wouldn't they be? They're neat front-end applications. But community banks aren't playing in that space at all. To the extent they have to use the payment system, they're doing it through money center banks. We're getting marginalized on the payment systems. If we get marginalized on the payment systems, then we've been cut out as an intermediary. Again, it's not going to go away.

How do we deal with it? One of the things that I would say -- and this is a theme, I think, that we talk about a lot -- one of the reasons why it's difficult for us to participate on the payment system side with the companies that are developing these apps is because our core processors won't give us a window into it.

MEMBER HASKIN: One of the areas that we struggle with is online accounting. That's the struggle for banks that are regulated. If there could be some clear definitions on how you can go
about those processes within the regulations -- I know there are banks that do that.

We've looked at it, and we've looked at it. It's hard for us to make that final decision to do that because we just -- it's hard to analyze the risk in that. I have read that that's one of the ingredients that is holding back the under-served from banking and banks is because they're asked to go in and provide all this documentation to a physical location and sign up for an account. If they were able to do that online and take that friction. You know, it's all about friction in your account. If I have to make someone come into my bank, that's additional friction. If they can go elsewhere, that is where they're going to go. That's one of the great concerns that I have.

I think we can all work together and figure out some type of method that's clear because, thumbprints, our customers can sign on online with their thumbprint, so they're online banking at our bank and that's a secure type of
innovation. That would be an issue I would ask you to explore because we still feel uncomfortable making that final commitment as a community institution.

MEMBER CASTILLO: A couple of observations that I've noted the last couple of months. I think it really has to do more on the lending side. Our little bank has explored how we might be able to take advantage of some of the efficiencies that technology provides.

I believe it's a lot easier said than done. I think a statement that Luke made earlier today is something along the lines that examiners are going to evaluate third-party activities as if the financial institution was providing that service directly. We've looked at either partnering with a company or buying stock, or if it allows us to more efficiently and more effectively manage our smaller loan originations. One of the things, in partnering with someone -- there's all sorts of ways that you can partner, but one of the things that really got my
board's attention is that, regardless of how those originations happen, if those loans -- if you partner with someone, whether it's On Deck or whoever it is -- that ultimately, if there was a problem, you're the financial institution.

You're where the buck stops. I think that's -- trying to manage that liability is going to be a huge, huge challenge. I think, as you go through these steering committees, and as you go through this research, there's two or three questions that come to my mind.

At this point, I don't really know how these are solved, but I do think that there's some very distinct differences between having a company help you with process, where you do it all in-house -- and there's a lot of companies out there like that -- between that type of a company and a company where you are read out their model or their black-box technology. You tell them what your credit factors are going to be, and then they crank them through their machine and tell you so-and-so qualifies, so-and-so doesn't. The ones that
qualify, you can charge this rate and be within fair lending guidelines. I think there's some huge differences there.

The other thing that I'm curious about -- and this is something that we've looked at in passing -- is does it make sense for a community bank like us, a small company, to buy the expertise versus partnering with someone? Because that way, you can control everything that you're doing, but there's some trade-offs there. I think that as you go through this research, those are a couple of things to look at.

I think from a risk profile, the other thing that we've determined is that we're bankers, and we have a much different risk profile than someone that has started an online lending company -- I'm just focusing on that for right now -- because they believe we're going to look at these 500 different factors, including Yelp and longevity and all of these different things, and you end up with, potentially, some compliance issues, but you have a risk appetite from a
potential partner that potentially is much, much
greater than what you, as a financial institution,
are willing to take on. Those are all things that
need to be evaluated within the decision-making
process.

MR. PEARCE: Just to follow up on that
a little bit, as we've looked at this space, one
of the things that strikes me is we've had guidance
outstanding on third-party relationship and the
management factors there, since 2008. Although
the technology is changing and there's lots of
things that have been evolving, the principles in
this guidance hold up well from, at least, my point
of view.

Just as you were describing, that
culture and the risk-appetite difference in having
institutions consider their own risk appetite as
they're thinking about what their strategy is going
to be to deal with new technologies. Are they
going to take a path where you hire internal
expertise because you'll have more control and be
able to monitor the implementation of that, and
then degrees to which you, then, are relying on outside firms. As you said, various and sundry partnership, there's lots of different ways to do that, but just being really intentional about what is your risk appetite, and then doing the due diligence of the firm and the monitoring of the firm and how you structure your contracts to be effective in managing that risk, it's really very consistent with our long-standing approaches.

MEMBER CASTILLO: Regarding the third-party risk guidance, we've used that -- we looked at a potential partnership. Our board read that, became familiar with it. We told this potential partner, here is this guidance. If you want to put a proposal together, address these issues here. The guidance really is excellent. This is where my culture comment comes from because when we got a proposal back, it was completely out of touch with what the guidance was suggesting. That's a culture type of thing.

CHAIRMAN GRUENBERG: Let me take the opportunity here, if you all don't mind, just to
go around the table and ask, I'd be interested if each of you could comment on acknowledging that you've actually committed your institution, and what is the spectrum, what worries you most about risk and issues both the positive and the negative.

MEMBER TOLOMER: We have a full array of electronic services, so online banking, business online banking, consumer online banking, mobile. The key for us is we're offering pretty much what all the banks are offering, large and small, to small and medium-sized businesses and the consumer.

We think we have a good product, and we're not concerned about that aspect. We also do the deposit and the like. I'm not at all concerned about the third-party lending. We talked about that, I think, two or three meetings ago. Some people were a little concerned about it.

You can see what's happened to Lending Club and management changes. I'll venture a guess that everybody here has been offered a portfolio to purchase or the loans that they've generated.
I'm sure we've all said no. So I'm not too worried about them. In terms of the payment systems, I think it's something you're going to have to look at. My sense is you'll get the more that happens, there'll be more regulatory oversight because it does affect -- I think Cynthia's right. It affects the banking system. I think from that standpoint, you've got to stick to your bank model and continue doing what you're doing and recognize that there's plenty of competition every which way, whether it's a traditional bank or it's one of these fintechs.

We'll have to see how it plays out, but I'm not too -- we watch it. We'll obviously have some level of concern, but I think we spend more time executing what we're supposed to be doing.

MEMBER SCULLY: I said just a few minutes ago, it's the payment system front end that worries me the most from a competitive standpoint. In terms of what we're doing now, we're participating on two fronts, one through our core processor, which is the consumer-to-consumer payments that can be made directly, so the standard
application, you can pick up with some of the core processors, but it lets them directly pay a consumer with an online application, and we're buying leads for one of our consumer businesses, but there's no requirement that we do anything with the leads. It's more of a marketing lead, so we're not obligated. We've rejected anybody that's offered to actually sell us portfolio loans to put in block portfolios. If we can't originate them, we won't do that. The two things that we're investigating are online accounting. I think, like Jane, we feel like we should be able to do this, but every time we look at the rules, we say that we can't do this.

Those of us that have legalized marijuana in our states, it's exactly the same argument. You look at it and you inevitably conclude, I can't do this, but others are doing it. Then we're looking at some of the fintech applications to help us originate, on the small business side, and to link things to sales management systems.
I think from an internal processing standpoint, we're very excited, see it as a win-win. In other areas, we're feeling threatened, in terms of can we compete with those who are starting to do this? But we actually have a permanent task force, obviously part time, of four officers in our company, all millennials from different disciplines, who are supposed to look at all of this and try to raise the flag for us.

MEMBER LUNDY: I don't have a lot to add to that. Probably the most effective tool that we use in our model is we brought deposit capture when we changed vendors about two years ago to upgrade that. We are going through a core process of conversion now. That process, which we decided on about a year ago, has delayed -- we're one of, probably, the largest banks -- and we also offer mobile applications.

With our business orientation, it just hasn't been -- it's a nice to have. We feel like we kind of need it just to say that we're a real bank, but the reality is most of our customers are
business people who don't really need to do business on their phone, but we will have that. To the risk point that we worry about, we have strategically gone after a number of large deposit pools of various kinds.

We call them channels. Some we've researched and successfully implemented, some we've gotten into the business and then abandoned it. But we're constantly looking at niches that we can basically attract deposit pools. Particularly in the current rate environment, large money center banks are awash in deposits and may not want them, so depositors can look for a regional bank like ours. It's big enough to provide the services, and yet, we're a rapidly growing loan portfolio, so we need the deposits.

We spend an awful lot of time trying to evaluate the BSA and the compliance risks and make sure that we don't get into some kind of inadvertent trouble for ourselves, for our depositors, from the regulators. I would say, in our particular institution, that's where we spend a lot of time.
We identify these large deposit pools, and we figure out is it really too good to be true, or can we bring these in and handle the risk elements of them?

MEMBER CASTILLO: I think that as far as technology, even for a small company, we have most, if not all of these services available. That's one thing that's been a huge benefit over the last ten years is that, regardless if you're a core processor, if the cost equation has changed so significantly that all of these things are available to us fairly quickly. On the concern side -- and listening to these young folks speak earlier today -- by the way, that was fascinating, some of their comments that they made -- I think the biggest challenge for us on the technology side, whether it's on the loan side or the deposit side, is trying to eliminate some of the friction points that Jane spoke about.

Because I think for us, it's still a very clunky experience for somebody that loves our bank, they have my cell phone, they can call me
Sunday anytime. But still, I can make them feel better, but my website or my application doesn't necessarily have all of those things available to them. One of them may be as simple as -- we have a PDF application for a loan on our website.

It's not interactive. They can't automatically send it to us. So the biggest challenge that we have is really making that experience online close to as good as it is when they talk to the person. Because there is that expectation that I can get on there 11:00 Friday night, and I can do all of this.

MEMBER WILLIAMS: Again, same situation with us. You pretty much have to have everything on the depository side, unless you're in the most remote of areas. We have had situations -- we only recently did, for example, instant issue debit cards. We've had customers walk out of the bank because they couldn't walk out with a debit card prior. You've got to have those things. P2P is going to get bigger. Venmo, I hear about it all the time.
My daughters Venmo back and forth. We have systems in place, but you've got to get bank information, and you've got to send an email. This is immediate. Now, Venmo requires that they both be signed up with Venmo. How can my customer get money that quickly to someone who's not a customer of the bank? Those are the hurdles that we're trying to get by on that.

On the deposit side, we've got the technology. It's there. We can be competitive. I don't think that's going to be an issue. I do fear a little bit, though, on the online lending side, for some of the reasons that Leo was just talking about here. It's just these little breaches of the front gate, these little pecks. Because so much of what we do relies on the relationships that we've established with our customers. When we initially had conversations at the national association/state association levels, FDIC level about these lenders, the old-line banker response was these guys are going after loans we don't want. They're making $50,000
unsecured loans with very little information. They're charging really, really high rates, big default rates.

Those are not the loans we want anyway. I fear that these guys are going to get better and better at it. There's issues with the model. Obviously, we've seen it. But I think they'll continue to. At the point, for my good customer, that a $10,000 unsecured loan gets to 21/2 percent online, and he says, Derek, I can't pay you 5; I'm sorry. I'm just not going be able to. I love you to death, but -- that's when they begin to breach the gate a little bit. That concerns me, that they're going to get better at what they do. The models are going to improve, and we're going to lose some business on that end. That's the concern.

(Off microphone comment.)

MEMBER WILLIAMS: Well, I suppose we could. The problem is overall, and they're using equity. It's the age-old problem of our situation versus some of the big banks. It's a cost of funds issue in the long run, the ability to have the
access -- when we're using local deposits, we've got a pretty fixed cost of funds. We don't have the access to some of the markets that the big guys have.

That's what concerns me is they're going find pools of money that are willing to take much less return on their money, pools of equity money, and cause us some problems. I think we may have that ability, but I'm worried about, from a technology standpoint, whether we'll take advantage of it or not.

MEMBER HASKIN: Several years ago, we made a decision that there were too many things that we wanted to keep in mind when we did our technology framework. One is mobile, and the other is real-time payments. Every decision that we make, we try to keep those two in the forefront of our decision-making process. We have a wide array now looking at the P2P. We've got all these new deposit transfer options. Many of the things that we're finding is that these are basically commodities. They're very difficult to charge...
for, so you have to save your money on the back side, and then personnel expenses and things off to really see the benefits of this. Our bank, when it was half the size it is now, had over 100 employees. Twice the size, and we have 37 full-time employees. That just shows the impact of technology in banking.

We're struggling with some of these friction points, but we're only as good as our core processor and their technology. Because what's happening, especially in the real-time space, is these -- when we had ATMs, we'd go out and find the best vendor to deliver the ATM service. Now, to get that real-time, that immediate transaction, you basically have to rely on your core processor and follow all of their products.

That's a process because you have these four and five-year contracts that you've signed up for. You have to really plan ahead four and five years into the future to know exactly how we're going to get to the end goal. That's been a challenge for us, but we've done a pretty good job
focusing on that and getting to those products. I still don't feel my experiences has a lot of the online competitors, the depository banks, but we're working on that. I think real time is going to be important to millennials. I think that everything is real time for them, and I think they're going to expect a lot of their banking. Right now, our P2P is the next day. It's not same day.

We have a lot of community banks that don't want to settle more than one time a day, so you're going to have to figure out some way to push those credit transactions through, so that they can do one-time settle. It's an interesting environment. We feel good about where we are. We'd like to do the online deposit opening, but we have to figure out how to get there.

MEMBER WILLIAMS: I agree with pretty much everything you were saying. I think one of our bigger concerns was just a general lessening of the amount of non-interest income you could get. We were secondary market in mortgage loans, for
instance. People are going online to get those. Cash management, you mentioned wires earlier. About a year ago, senior management and our board sat down. We took a different tack. We all follow the same products, and we all have the same major core processors and everything. We actually got into a new line of business, figuring that we needed that line of business to offset the revenue loss that we're going to have in the future. We got into credit cards. Nine months, we decided to become a credit card issuer.

Benefits of that, obviously, with Dodd-Frank, is we get the full interchange, versus the larger banks. On top of that, you have a MasterCard or a Visa that is basically updating their technology and carrying you along with them, so you're not actually having to go out there -- it's a canned product. You don't have to go out there and do it.

It fit very well with our commercial strategy, in terms of cash management for our corporate customers. So we kind of took a little
bit different tack, in terms of not trying to fight
the battle of staying ahead of it, but just trying
to find another source of revenue, and that was the
credit card side.

MEMBER BRYANT: Our situation is
completely different, in that we don't offer
transaction accounts. We have, in the last couple
years, started offering online banking. We have
also looked at acquiring institutions that will
give us access to transaction accounts. But one
of the things this meeting has confirmed for me is
that I'll probably attend a technology conference
to explore ways that we can grow our institution,
by looking at non-traditional sources for
financial institutions.

MEMBER BLANKENSHIP: Well, in our
bank, we offer just most of the services that are
readily available, but we're in a metropolitan
area. To stay competitive, we're more or less
forced to do that. We have found that there's not
any one sector that's more accepting of new
technology. Where you would think maybe the Baby
Boomers or some of the older generation would be more hesitant to use those products, we really found that they embrace that.

The P2P, I think, is still based largely on a next-day ACH transaction, but there, again, it goes between two banks, so if something goes wrong, what's going to happen there, when you have no control over who's initiating that? That remains a concern. I think generally, with technology, the biggest question is just risk versus reward. Where is our risk tolerance, and how much of that are we going to be forced into taking to stay relevant in the market? Then you have to decide if you want to stay relevant, particularly in the payments area.

I do think relief for online opening of accounts -- and I understand that there's just inherent risk in not seeing that customer face to face, but maybe there could be other criteria that you could get around that.

Because my millennials, my daughters, I think that's what that generation and, I think,
honestly, our generation will come to expect
because it's all about accessibility and
convenience.

If you can't deliver that, whether it's
in person, because you're always available and you
always answer the phone, or if someone can't open
an account, or at least apply for a loan over the
weekend, when they found a new travel trailer or
something, people, they expect it now. They
expect an answer now. They think that we have the
technology to look at them and say, yes, you've got
a great credit score. There are technologies out
there for community banks. Sometimes the cost is
the inhibitor. That would be an issue. One of the
other things that I think, as we talk about
technology, is we're really looking hard at social
media and the roles on social media and what impact
that will have on payment systems and deliveries.
How is that promoting customers away from us, or
can we use that to our benefit?

That's something that's going to fall
largely under consumer compliance. Look at what
a gigantic role Facebook and Twitter -- somebody tweets out, there's a better way to make your payment. We're at a competitive disadvantage. That's real, at least in my mind.

MEMBER SCULLY: Or if we do try to put it out there, it can't be done in a tweet because we have to do so much disclosure around the product every time we talk about it.

MEMBER BLANKENSHIP: Yes. Other than that we offer --

MEMBER SCULLY: It's true. We tried to do it, and you have a heart attack. We can't do that.

MEMBER BLANKENSHIP: That is true. We're a major sponsor of two festivals in our community. I meet with the CVB board. Every time they put our logo up -- now they tease me. I mean, that's an educational process for that.

MEMBER THOMPSON: The thing about being the last is it's hard to sound a whole lot different. At our size bank, we offer -- at 125 million, we pretty much offer all the same products
as everybody else does, just like everybody said. You have to, if you want to keep the doors open.

The big challenge for us is are we -- we put in a lot of new technology in the last year, year and a half. Part of the thing for us, are we monitoring enough? Are we monitoring all the right things? You want to continue to add the technology, but then you have to do all those things behind the scenes.

Jane, you can cut down on those employees, but you've still got to monitor and measure whatever it is that you're putting out there, not just for regulatory purpose, for our own purpose. Did you spend the money on the right things? Are you getting any return? The board wants to know every time you put in a new product what's it doing for you? I think for us, at our size and number of employees, it's trying to keep up, but also trying to be sure that you're monitoring everything that you've got out there in the right way.

MEMBER EMMONS: Could you repeat the
question, please? I would echo a lot of what has been said. I don't know that there's any technology that we've actually developed, you know, it's -- we are so dependent on our core provider and vendors.

To me, we've spent a lot of time talking about the person to person, kind of that retail side of the business, which -- we've been listening to the folks earlier, the young folks earlier today -- really kind of starts with the definition of commoditization that's taking place.

I think to our world, commoditization is not a pleasant thought. I think what's particularly concerning about it for us is the pace of change and the fact that it's coming so quickly that it constantly feels like we're addressing another payment system, another model that's in the market that our customers, our consumers are interested in, and that obligation of feeling like you have to get it. You've got to provide it. And so there are all of these options. We're early adopters, but at some point, there's just going to
be a plethora of payments that are in that P2P space, and that concerns me a lot.

The kind of a holdout, I think, in this conversation, is really the business to business or the commercial side of our business, where our deposits have not -- we're not seeing the kind of changes that we're seeing on the retail side.

Cash management systems and the way that we deliver services and the treasury functions with the businesses still can be customized, still can be priced, and still makes a difference. You can build relationships on that side of the business.

I think our sitting here today and saying what would be the greatest risk is that a similar kind of wave of technology passes through the business to business side of payments, and it becomes very similar to what we're experiencing on the retail side. All of those deposits, all of those transactions bypass the banking system, and we're left with a real strategic challenge. I think in the current environment, I think our job
is to make sure that we're on top of all of the changes that are coming and prepare ourselves to be able to afford that technology and work.

MEMBER WILLIAMS: Chris, you make a valid point. That whole idea of there's so much stuff coming, and you don't want to miss the one that is going to be the death knell to the banking industry. You're afraid that that one will slip by, so you're looking at so many of which will be gone in six months as a fad. It's hard to keep up with it all.

CHAIRMAN GRUENBERG: Thank you. I noticed our staff feverishly taking notes through all of this process. I think this has been -- Ms. Eberley.

MS. EBERLEY: It's very helpful, thank you. I think you've given us some things to work on and some things to think about and see if we can't maybe deliver on some of the things you've asked for.

MS. RYAN: Okay, well thanks, Doreen, Jim, Rae-Ann, Jonathan, and Mark. We're going to
move into our last panel right now. Doreen and Rae-Ann are going to stay with us, and we're going to be joined by Mark Moylan, Deputy Director of our Division of Risk Management Supervision, and Bob Storch, who you saw earlier, as well. The focus is going to be on recent supervisory developments, including a new work program for examiners called InTREx, and FASB's new CECL accounting standard. I'll let the group here explain those acronyms. I'll turn it over now, again, to Doreen.

MS. EBERLEY: Okay. I think, again, we'll just kind of go down the line. We're going to talk about the new IT examination program, broker deposit FAQs, and our -- an incentive comp, and our guidance on the private sector loss model.

MR. MOYLAN: Good afternoon. I'd like to speak to you today about InTREx. I've kind of hinted around of what we've been doing with InTREx and really, the revisions to our prior examination program. Really, InTREx -- or the Information Technology Risk Examination Program -- is really an enhancement of our IT examination work program
that we've historically worked through. The regulatory requirements surrounding a bank establishing an appropriate information security program is really nothing new. However, the parameters set forth really have lacked the recognition of cybersecurity, cyber risk. Certainly, our enhancement was in recognition of that new risk component.

InTREx now specifically recognizes the emergence of the cyber risk element and better aligns and defines regulatory expectations in the assessment of a bank's information security program and the identification and mitigation of this new risk.

Really, InTREx introduces three areas of change, pre-examination procedures, changes to the format and structure of the examination work program, and new examination findings procedures. All of these changes are made to affect better risk scoping, enhance the examination process, and increase transparency, as well as board awareness.

Let's talk a little bit about the
pre-exam procedural changes. If you remember, we had the IT questionnaire. It's been replaced by what we call the IT profile document. The IT profile document has 65 percent fewer questions for bank officials to answer -- so I'm sure you applaud that -- is better focused, in my opinion, and bank officials will now receive the document and have approximately two weeks to complete and submit to the FDIC. It's going to allow you time to talk to your staff and not have to do it so quickly. I think the thoughtful preparation is a benefit to us all.

The two-week preparation time, along with more effective questions, will provide the examiners with better information to risk focus the examination and appropriately staff the examination commensurate with the risk profile of the institution. I want to talk a little bit about the actual work program, itself. In your package, you're going to have one of our modules, which is the audit module.

This is the actual work program that we
have developed, and it is really the framework which the examiners will go through. The work program modules now directly correspond to each of the uniform rating systems for information technology, or as we call it, URSIT ratings. If you look at the audit modules, the work program provides examination staff with specific decision factors and analysis procedures, including basic and expanded procedures. It also creates an opportunity for those that may have a more complex environment to incorporate the FFIEC handbook work programs. Our examiners now, for our smaller institutions, will use this program, and this will be the framework for all of it, but if we do have some areas that are more complex, then they will scope in and use the entire FFIEC handbook work programs, take those findings, and then flow them up consistently with the URSIT ratings.

As you will note in the program, it also highlights the various components and direct relationships within a bank's information security program that relate to cybersecurity, as well as
the information security standard, pursuant to the
Gramm-Leach-Bliley Act. If you turn to page 5 of
the audit program, you will see a private approach.

As you can see there on the left, you
will see, in this case, a cyber flag. That element
relates to cyber. Again, understanding that
cyber's really through all of these components,
this highlights for our exam staff that this is one
of the main elements associated with cyber. I
didn't give you a module that had
Gramm-Leach-Bliley, but you will see a similar flag
for Gramm-Leach-Bliley. Those specific elements
and decision factors that they're looking at as it
corresponds -- even though we're looking at your
entire information security program, these are
elements that are particularly specific to cyber
in the Gramm-Leach-Bliley Act.

We believe this new program will
provide better examiner guidance, a more
consistent examination approach, and better
support of the conclusions drawn. If you also
notice, on the first page of the audit -- and this
is something that has been something we've been really working on, and we will continue to work on as we move forward -- on the decision factors, you will see, at the bottom, a category from strong to critically deficient.

As the examiners draw their conclusions in those areas, in the work programs, what this is going to allow us to do is to perform horizontal analysis. We will be able to take all of these work papers of all the examinations that are conducted around the country and then be able to sort and pull together maybe areas that we're seeing a higher level of less than satisfactory, satisfactory, see the specific comments, and then draw some conclusions on areas that will give us an opportunity for better training, maybe more guidance, and have that horizontal capacity. Every one of these that's performed at all of your institutions, they will be checking these boxes.

At some point in time, we will start drawing that information out, so again, more of a horizontal perspective and analysis on that. One
of the things I do want to mention, I think, again, with support from Doreen, is that if you go to the financial institution that was issued, these components and these modules for audit management, all of the URSIT ratings, as well as the IT profile program, are now available to the banks.

They are available by clicking the link in the financial institution, so your staff and yourselves have these modules available. You'll be able to preview them, understand some of the elements we're looking at, again, the cyber flags, the Gramm-Leach-Bliley flags. These are all available to all of you through our fdic.gov website. That's, I think, something, again, on the form of transparency. This is what the examination staff is looking for, and this is available to you folks. Lastly, which certainly we've been a strong advocate for, we worked with the Federal Reserve, and also CSBS, on this program.

They were partnering in this program.

One of the things was we wanted to move, also, in
the transparency, to now disclosing the entire URSIT rating. Historically, we've only been disclosing IT composite rating. We will now be disclosing all of the components. I know all of the bankers I have ever -- they know what No. 1 means; they know what No. 5, they know what No. 3 means.

Certainly, I think it will create much better of a discussion. You may have been a composite 2 in the past. In fact, you may have had recommendations regarding audits. But now, if you know we have rated the audit a 3, that will probably perk up everybody's ears. I think that will allow the board to understand, ask more questions, be attuned to those recommendations, so all of the composite and component ratings will now be disclosed in the examination reports. The ECC page will still give a summary comment regarding the IT overall examination findings. It will disclose the comment pages. But there will now be -- what used to be an optional page, called our information technology assessment page, is now
mandatory.

On that page will be a discussion of each of those components and the rating. Also on that page will be a summary comment on your cybersecurity preparedness. It's basically taking those components, with those flags, and bringing them into a context specifically rated to cybersecurity, very similar to what we've done historically in the reports regarding Gramm-Leach-Bliley.

Now, you will have the transparency of not only seeing the components, you will have an examiner opinion of your cyber preparedness. Obviously, if there's elements in recommendations, you will see that in the context of your cyber preparedness, just as you've seen on your Gramm-Leach-Bliley. Really, our goal is, again, to not only give our staff a better program recognition of the emerging risk of cybersecurity, increased transparency through the component ratings, hold better discussions with management and the board regarding all of these areas, and
certainly, last, but not least, I think this is a major benefit that these work programs are now available to you folks on our webpage, to where you can understand the thought process, the areas that are available, and what the examiners will be looking at through this process. Any questions?

A memo went out June 30th. There'll be some pre-exam time, so no later than -- you should start seeing the use of the new program no later than October. If you have an examination scheduled, 1st of October. There may be some that'll be done a little bit earlier if the bank is open to it and we're able to pre-plan.

You may or may not be getting the full package, but I certainly would be very interested in how you feel that exam goes.

MS. MILLER: Also on June 30th, my group issued an FIL on an updated set of broker deposit frequently asked questions. We call them FAQs. We originally issued the broker deposit FAQs in January of 2015. We did that basically to provide plain language information about
categorizing broker deposits all in one place.

We talked in that FIL back in January of 2015 that we would update it periodically. Section 29 of the FDI Act and Part 337 of our rules and regulations define the term deposit broker. It restricts the acceptance of broker deposits by insured institutions that are not well capitalized.

The FAQs are based on the statute and on a regulation, but also on explanations of the requirements that we have provided to the industry through what we call our advisory opinions from time to time. We also published a study on core deposits and broker deposits back in 2011, as part of the Dodd-Frank Act. There's a lot of information in there about categorizing deposits. After that initial release in January of 2015, we conducted a banker call-in. We had visits with a number of trade associations and other institutions. In the spirit of updating them periodically, we issued a revised set of FAQs in November. We addressed many of the points that
people came in and chatted with us about in those outreach sessions.

We got nine comments on that November release and updated the FAQs accordingly, where appropriate. The updates since January, we have new questions on government pre-paid cards. We've got new questions on deposits gathered through dual homed and call center employees, and then we clarified a number of other questions. We also added footnote citations to those advisory opinions, where appropriate.

I think that was a real helpful additive when we went out for comment in November. We also emphasized that the FDIC takes a case-by-case approach. A lot of these products are very idiosyncratic. You could change one little factor, and it would change the determination, so we want to make that clear. In that regard, we continue to get inquiries. I'm working on several right now. As we get through those, we'll update our advisory opinions. Then once we get enough of those, our intention is to update the FAQs, as well.
MS. EBERLEY: Maybe just one point.

The footnotes that we added throughout point directly to existing advisory opinions that are outstanding that relate to issues, so you can see how the question relates to something that's already been evaluated or to the broker deposit study.

MS. MILLER: Then with regard to incentive compensation, we issued an NPR, notice of proposed rulemaking, on April 26th, regarding incentive compensation. This is per Section 956 of the Dodd-Frank Act.

That section requires six agencies -- us, the OCC, the Fed, the NCUA, the SEC, and the FHFA -- to jointly prescribe either guidance or rules that prohibit any type of incentive-based compensation arrangements or any feature of those arrangements of the agencies determined to encourage inappropriate risks by a covered financial institution. 956 also requires that financial institutions disclose to the appropriate federal regulator the structure of
incentive-based compensation arrangements sufficient to determine whether that structure provides excessive compensation that could lead to material loss to the institution.

956 applies to incentive-based compensation arrangements offered by what's called covered financial institutions, and that's insured depository institutions, depository institution holding companies, credit unions, broker dealers, investment advisors, Fannie Mae, Freddie Mac, and other institutions that the agencies jointly determine should be covered by the rule.

Within those covered companies, those over $1 billion are covered. Any of you that are under that, institutions that are less than $1 billion, are exempt from the rule. The NPR uses a tiered approach with respect to its requirements, so there's a Level 1, and that goes from 1 to 50.

I assume you would all be in the Level -- excuse me, Level 1 are $250 billion or more; Level 2 is $50 to $250, and Level 3 is $1 to $50 billion. That's where I assume you guys are.
All covered institutions would be subject to a set of basically programmatic elements, policies, procedures, and recordkeeping type of requirements. Then as the institutions get larger, it would be subject to more stringent provisions.

Importantly, for those larger institutions, the Category 1s and 2s, the proposal would require minimal deferral amounts and time periods for incentive-based compensation for the senior executive officers and those employees that could expose the institution to material levels of risks.

In the proposal, we call them significant risk takers. The proposal requires those amounts to be subject to forfeiture and downward adjustment in the event of certain things that would happen. The proposal also has other prohibitions for those larger institutions.

Those include prohibitions on purchasing personal hedging instruments, clawback provisions for already vested amounts, and there
are also requirements on enhanced governance, risk management, and recordkeeping for those larger institutions. Any questions on my two items?

MEMBER SCULLY: I have one question. I obviously only looked at it so long. This is on the incentive-based --

(Simultaneous speaking.)

MS. MILLER: You didn't read the whole thing, the 600 pages?

MEMBER SCULLY: No; I'm sorry; I didn't. Is there a way to more -- I think almost everybody in this room, at best, is going to be a Level 3, maybe not even a Level 3. Much of the documentation seems to refer to Level 1 and Level 2. I understand that because of the concern. Is there a way to just restructure it in a way that it's easier for those of us that are Level 3 to find what applies to us, as opposed to what doesn't apply to us? I understand why all the emphasis on 1 and 2, but my first attempt to read, I could hardly find references to Level 3.

MS. MILLER: Yes, we will certainly
take that into consideration. The early comments are this is an extremely complicated --

(Simultaneous speaking.)

MEMBER SCULLY: -- more prescriptive than it's been in the past.

MS. MILLER: It's open for comment. We're taking all comments, that's for sure. When you move to a final rule, your comments are very helpful. We try, when we issue financial institution letters and press releases and things, to communicate what's important, especially for community bankers, so certainly, we'll do, hopefully, a better job of pulling that out and communicating that.

(Simultaneous speaking.)

MEMBER SELESKI: I think it would be difficult to -- this is like War and Peace -- to --

MS. MILLER: It's better, though.

(Laughter.)

MEMBER SELESKI: Everyone wants to comply with the rules and regs. I think we need our five millennials here to interpret this. I
think for the examiners coming in, I just think everyone needs to be on the same page. Because we all want to comply, but I almost have to hire a consultant to look at all the compensation plans of the people that would be involved to make sure they comply because you don't want to be written up. The board's going to be looking at this and saying, "Why?" I agree. It needs to be simplified, a chart, examples, and that type of thing --

(Simultaneous speaking.)

MEMBER SCULLY: There's a reference somewhere in here, I saw, to the Level 3 -- the basic blah, blah, blah applies.

MS. MILLER: Programmatically, yes.

MEMBER SCULLY: I couldn't find -- I'm sure it's in here, but I couldn't find what is the basic?

MS. MILLER: That's really helpful.

MEMBER SCULLY: I don't think anybody's trying to be lazy or critical because I understand the need to focus on those 1s and 2s,
but it's going to be really tough to get through this. As David said, your boards and your comp committees are going to be all over this.

MS. MILLER: Yes. Certain things we've done with other rules are user guides. This, of course, is still in the comment phase, but videos and training and things like that. We can certainly consider those issues.

MR. STORCH: Shall we move on? Good afternoon. You have to suffer through me a second time today, but we'll see which topic is preferable. A little more than one month ago, on June 16th, the Financial Accounting Standards Board -- I'm sure you know the acronym FASB.

Anyway, the FASB issued what's known in accounting parlance as Accounting Standards Update, or ASU 2016-13, on the measurement of credit losses on financial instruments. The new standard was the culmination of several years' work by the FASB to improve the accounting for credit losses.

The ASU formally introduces what has
come to become known as the current expected credit losses, or CECL methodology for estimating allowances for credit losses. This will replace today's incurred loss methodology when the new standard takes effect. The move to the CECL methodology represents a significant change to current allowance practices both for the agencies and for your institutions and the industry, as a whole. The new standard can be downloaded from the FASB's website if you do want -- members of your staff need to obtain a copy. On June 17th, the day after the release of the new accounting standard, the FDIC and the other federal financial institution regulatory agencies issued a joint statement on FASB's new credit losses standard to provide initial information directly to all institutions about the new standard, including initial supervisory views regarding the implementation of the CECL methodology by financial institutions, and a copy of the joint statement is attached to the FDIC's Financial Institution Letter 39-2016 in your handout.
In its simplest terms, the allowance for credit losses under CECL is a valuation account measured as the difference between the amortized cost basis of financial assets and the net amount you actually expect to collect on those assets.

In other words, the allowance is an estimate of lifetime credit losses for however long those assets will remain on your balance sheet. The CECL methodology applies to all financial assets carried at amortized cost, including loans or investment, your traditional loan portfolio, and to your held in maturity securities, as well as off balance sheet exposure, such as loan commitments and standby letters of credit. The new standard also updates the measurement of credit losses for available for sale debt securities.

To estimate expected credit losses under the CECL methodology, institutions will use a broader range of data than other existing generally accepted accounting principles, or GAAP accounting. These data include information about
past events, current conditions, and reasonable and supportable forecasts relevant to assessing collectability of cash flows on financial assets.

In contrast, under today's incurred loss methodology, only past events and current conditions can be considered when estimating credit losses. What are differences between today's incurred loss methodology and the CECL methodology, the FASB strived to ensure that the new accounting standard will be scalable to institutions of all sizes, and the agencies expect that to be the case. We also do not expect smaller and less complex institutions will need to implement costly and complex modeling techniques. Institutions should be able to modify their existing allowance methodologies to meet the newer accounting standards. In so doing, institutions will, however, need to change certain of the inputs and assumptions they use to achieve an estimate of lifetime credit losses.

Acceptable estimation methods under the CECL methodology that are identified in the
standard include loss rate methods, world rate and migration methods, discounting cash flows, probability of default and loss given default methods. The new standard explicitly states that institutions are not required to use a discounted cash flow methodology to estimate expected credit losses.

Because the ASU doesn't specify a single method for measuring expected credit losses, the standard allows institutions to use judgment to determine the relevant information and estimation methods that are appropriate in their individual circumstances. In addition, an institution may apply different estimation methods to different groups of financial assets. Estimating allowance levels under the CECL methodology, including assessing qualitative adjustments to historical lifetime loss estimates, will involve a high degree of management judgment. You're already employing considerable judgment on today's model, and that will be increased under the new model.
Therefore, consistent with our existing accounting and supervisory guidance, allowance estimates under the CECL methodology should continue to be based on the comprehensive, well-documented, and consistently applied analysis, as appropriate to the size of each institution and the nature, scope, and risk of its lending and other credit risk-taking activities.

The FASB has provided significant lead time for institutions to prepare for their implementation in the CECL methodology until the new accounting standard takes effect. At the same time they provided the agencies with significant lead time, as well, for us to prepare.

In fact, since our discussion about the CECL methodology at the advisory committee meeting in early April, the FASB moved the effective date of the standard out one more year from where it had originally been set by the FASB in November of last year. As a result, for those institutions that, for accounting purposes, are deemed SEC filers, the new standard will take effect in 2020. All other
institutions will begin reporting under the CECL methodology either in their first quarter of 2021, or as they end the fiscal '21, depending on an institution's characteristics.

In the joint statement, the agencies encouraged institutions to start their planning and preparation for the new accounting standard now, including becoming familiar with the new standard.

I would include in that ensuring that your directors begin to get a basic understanding of the new standard, since it will change the metrics that you look at, in terms of allowances versus loans, identify the data needs and necessary systems changes to implement the new accounting standard consistent with its requirements, the allowance estimation method or methods you expect to be using, and our supervisory expectations. Then determine how and when to begin collecting additional data that you may need, and then finally, assess the potential impact on the new accounting standard on capital. Both during and
after the transition to the CECL methodology, the agency's goal is to ensure consistent and timely communication to institutions about the new standard and to develop and issue updated supervisory guidance pertaining to the standard, particularly with respect to smaller and less complex institutions.

I might just add, before we turn it over to questions, tomorrow afternoon, in fact, the FASB has scheduled a webcast for 1:00 to 2:00 p.m. You can register at 4:00 through the FASB website, or if you have staff that you would like to have hear about it, you can register through the FASB's website.

If they can't listen tomorrow, it's going to be archived and available for three months on the FASB's website. There's other materials that FASB has issued, as well, to help support the understanding of the new standard. With that, we can turn it for questions.

MEMBER HASKIN: I commend you for repeatedly, it emphasizes the complexity for small
banks, that it should be matched with the complexity of loans. I do appreciate that. I think that's something unusual. I commend you for it.

MR. STORCH: The industry, as a whole, also was very forceful, I would say, communicating that need to the FASB. I think they heard that loud and clear, especially over the last six to nine months.

MEMBER WILLIAMS: I'm not sure this is a proper question to ask, but I'm not back after today anyway. What do you foresee as the FDIC's role for the FDIC-regulated banks as we move toward implementation? Do you see beginning to help us start looking at our models a couple years out that we're putting in place?

MR. STORCH: That's one subject that the accounting policy staff at the agency have been talking about is what sort of expectations we should have for our examiners to be looking at where you are in the process. Staggered effective dates is not like one size fits all, so certainly,
institutions can't wait until the last minute. Those sorts of questions are on the list of what we would expect to be communicating. Thinking now about what the timeline ought to be, when you may want to have whatever system changes in place, so you could perhaps do some dry runs in advance of when it actually takes effect with major reporting, involving -- it's not just an accounting exercise involving whoever you're using for IT, obviously, but your credit risk management staff, whoever's providing support from an internal audit/internal control standpoint, so making sure that those types of functions throughout the bank that are impacted are involved and how soon they should be involved and so forth.

There's not a single good answer, at this point, but that's one issue that the agencies will continue to talk about, so that we don't have examiners going to one bank, having one very high-level set of expectations, which is outside what would be acceptable, and other examiners ignoring the issue entirely.
We're going to have a good level of examiner preparation and some teaching for them, so they understand, as well. At the same time, they have to remember what the current accounting standards are. I'm sure you and all the banks are applying the current standards until the effective date.

MEMBER WILLIAMS: It's probably on the radar. I think that's the main concern. I wouldn't expect there to be a one-day switch foot, although there will be, as far as what we're required to do. It's going to be a great deal of preparation still. I certainly foresee periods of running the systems parallel to see what we're doing.

MR. STORCH: I think it would be fair to say that none of us should expect that everyone's going to get it perfect on the first day. I think even in talking to the FASB, they recognize that there'll be some gaps in the data on day one, which you'll have to factor in qualitatively to adjust for that.
Over time, as you build up more data, you'll be in a better position to achieve what the ultimate objective of the standard was. That will be something -- not expecting perfecting on day one, I think, is a message we really need. Our management's agreement is to give out to our examiners, as well.

MEMBER HUDSON: That's such a big source for community management.

MR. STORCH: That's an issue we've heard repeatedly. In our joint statement, we've tried to signal that if you're appropriately segmenting the portfolio today, under the current loss model, then maybe based on the call-in work categories, the standard, in and of itself, doesn't require you to change that. Certainly, for community banks, you want to get that message out there. Because we were hearing from sources that we'd have to implement dozens of new categories. We didn't see the need for that.

MEMBER CASTILLO: I have an observation. I just got an examination report,
and in the examination part of the discussion was, have you heard of CECL? And I read the report on Monday, but in the examination, itself, it says, "CECL is coming, and we expect management to start advocating itself."

I'm curious as to whether FASB or the FDIC has modeled what they think an allowance might look like under the CECL method? The reason that I ask that -- and this is a sentence that just jumped out at me, and this is on Page 6 -- it says, "Institutions should not begin increasing their allowance levels beyond those appropriate under existing U.S. GAAP in advance of the new standard's effective date." As I read that sentence, it implies the reserves are going to go up. Any thoughts on what's been modeled or what --

MR. STORCH: The FASB, in some other materials, they may even be included in what they do tomorrow; I don't know -- sort of tried to look at different segments, particularly the loan portfolio, to see what the potential impact would be. For your shorter-term loans, where maybe
there's an average of a one-year life, that's what
you're pretty much doing today under incurred
losses.

What losses do you expect to realize
over the next year or over, let's call it a loss
emergency, some loans can go over. In that case,
there's probably not much of an impact at all. For
your existing loans that are impaired loans, the
methodology really will still be the same, even
though the term impaired loans isn't in the new
standard. When you get to more medium-term loans,
then there could be some modest increase because
you'll be looking at two to five years for the
longest term loans. Think of residential
mortgages with a seven year average life. That may
have the greatest impact. It's going to depend on
the portfolio mix as one factor, also on economic
conditions when we get to '20 or '21 because you
have to have forward looking information for this
reasonable and supportable forecast period.

In most cases, it'll be one, two, three
years. In the worst economic times, you may only
be able to get forecasts in a very short run. The bank's still expected to provide, based on loss experience, for the entire life of the loan and not ignore credit losses that might occur beyond the period for which you can forecast. So there's a lot of uncertainty.

There's been some press coverage, over time, that the OCC have done some studies in 2013, which is shortly after the proposal was first proposed. Of course, that was based on 2012 data. Allowances and portfolios are different now than they were then. They had to make a lot of assumptions. At that point, they came up with sort of a general range of a 30 to 50 percent increase in allowance levels, with lots of caveats attached to that because their range is much wider. But part of the exercise of going through that was because when the proposal was issued, some banks and some commentators were suggesting allowance levels would increase 300 and 500 percent.

There was a concern if that was actually going to happen, would banks be prepared for it,
and is that improving an accounting or not, bottom
line? Part of the SEC's exercise was to see, on
a general scale level, what type of increase might
be expected. It's really going to vary, depending
on the characteristics of your portfolio, where the
economy is, and where your allowance level is under
the current standards going into the change.

MEMBER BRYANT: Let me ask this
question, and it's tied to the question he just
raised. I think the model would be extremely
valuable because my initial reaction would be to
shorten the loans in the portfolio. Then if you
are expecting rising interest rates, and then
certain economic future, what's that going to do
to the model? Because you can manage the
portfolio, you may have short-term, maybe 12 months
-- this gets larger when you go out 24, 36, 60
months, and 84 months. Sitting here today, still
here tomorrow.

MR. STORCH: A starting point always is
what your historical, now lifetime, loss
experience has been. To the extent you have loans
today for which you had similar types of loans in
the past, most banks typically have annualized loss
rates.

They don't normally have constructed,
unless they're perhaps doing the probability of
default loss given the default that the largest
banks do, they haven't constructed loss curves to
see how losses occur over the lives of loans. For
most loans, from what I've seen, the losses occur
out two to three years, and then they taper off.

That two to three-year time horizon we
keep talking about probably is where the peak of
any losses would occur. There'd be some
thereafter, but the performance would likely
revert back more to what your lifetime experience
is for those outer meters of the life of the loan.

In theory -- and I can't say whether this is a
working practice -- FASB's trying to say how do
banks manage the credit risk today? Presumably,
as good credit risk management, you are looking at
what you expect to happen in the future, both when
you grant the loan, and as you work with the
borrower to collect the loan. This proposal, and
the standard, now it's out, is intended to better
align sound credit risk management practices with
the accounting.

If your credit risk management people
are factoring in likely future events or expected
future events into their assessment of how we're
going to manage the portfolio, they'll now bring
that thought process into the estimation and
re-allowance going forward, at least starting in
2020 or '21.

MEMBER BRYANT: We had losses the last
two years, so if we can keep that to 2018-2019, I
think we'll be in pretty good shape.

MR. STORCH: You still have to look at
lifetime loss experience as kind of a baseline, and
then say given what our baseline experience is, how
do we expect conditions over the forecast period
in the life of these loans to be different than
those good years, where we haven't had any
charge-offs? It's not likely that a zero
allowance or some very tiny allowance would be
acceptable, but it's going to depend on your facts
and circumstances. One of the messages is should
it always have been under the existing rules the
allowance is an institution-specific number?
There's no one right number that's right for all
institutions, although sometimes you hear people
arguing that.

MEMBER LUNDY: I do think, just from an
observational standpoint, there's already been a
lot of margin pressure the last five years.
Bankers and our regulators, based on our historical
experience, have been rightly concerned about
interest rate risk.

Of course, if we could all look
backwards, we realize that we've left a lot of money
on the table, as an industry, trying to guard
against that interest rate risk. I don't know
what's going to go on in the future, but I do think
that Pedro's on to something. I think that this
will tend to compress duration, and I think that
will put more pressure on margin for community
banks who have less ability to lay off that interest
rate risk and are more dependent on spread income. I can't quantify that, but one way to guard against either an imposed or too difficult to figure out expected risk loss in years three, four and five is to, as a protective measure against criticism, shorten that duration, which may make you less competitive from a pricing standpoint. I think, in particular, the smaller banks' segment, which is so dependent on spread income, has to worry about that and how this impacts our earnings.

MEMBER WILLIAMS: I just think you guys just keep your eyes and ears open for it. I understand the concept that every bank is different, every bank has different risk profiles. I understand all that, but this will come down to some kind of a fairly simple model, with tweaks related to the riskiness of the classification of loans within the bank and that sort of thing, the individual data that we have.

But there will be some standard for how we track this information -- akin to the idea of historical losses, where you say did you use a
rolling 24 months, did you use 36 months? There's all kind of tweaks, but there's some history period that you -- I think it's going to come down to some model. I know you guys have to be very careful that you don't manage our banks. I understand that concept. But I think any help, as that model begins to fall into place, to make it easier for us. Does that make sense?

MEMBER SCULLY: I'm sure you've already done this, but I think, also, staying in touch with not just FASB, but individual accounting firms. I know our accountants have said that because of the vintage approach, no matter what anybody tells us, there's no way we can keep doing this on a spreadsheet, no way. That involves some level of complexity.

(Simultaneous speaking.)

MR. STORCH: I think the FASB has tried to dissuade people of that. There's some vintage disclosures for banks that are -- for accounting purposes are called public that has to be provided. That's disclosure, not measurement. FASB's tried
to distinguish vintage measurement from vintage disclosure. If you look at the standard -- or the people that deal with accounting look at the standard, there are examples that the FASB has included of loss rate methods and so forth, to make it clear that from a community institution perspective particularly, those methods are acceptable. There is also a vintage example, but it's clearly not the only example of how to apply the methodology. The agencies do have some meetings with accounting policy staffs and accounting firms that we are scheduling now, just to find out what issues they're hearing from their clients and so forth.

We've also indicated to the trade groups that we're more than willing to work with them on issues that they're hearing from their members. I think we all want to get this as right as we can, acknowledging that it's an evolutionary process before takes effect, and even after it takes effect.

MEMBER WILLIAMS: We can all dream that
you guys will come out and say just do 50 percent.

CHAIRMAN GRUENBERG: That sounds familiar. Anything else? We focused on this and be as helpful as we can. Thank you all very much. To those of you who this is your last day, we'll miss you, and please stay in touch. The rest of you, we'll see you the next time. Thank you.

(Whereupon, the above-entitled matter went off the record at 2:49 p.m.)