FEDERAL DEPOSIT INSURANCE CORPORATION

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ADVISORY COMMITTEE ON COMMUNITY BANKING

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MEETING

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WEDNESDAY,
JULY 11, 2018

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The Advisory Committee convened at 9:00 a.m. in the Federal Deposit Insurance Corporation Board Room, 550 17th Street, N.W., Room 6010, Washington, D.C., Jelena McWilliams, Chairman, presiding.

PRESENT:

JELENA McWILLIAMS, Chairman, FDIC Board of Directors
MARTIN GRUENBERG, Director, FDIC Board of Directors
TIFFANY BAER PAINE, President & CEO, Security Bank USA
ADRIANA M. BOEKA, President & CEO, Americas United Bank
ASIF DAKRI, Vice Chairman & CEO, Wallis State Bank
CHRIS DONNELLY, President & CEO, Bank of the Prairie Olathe
DAVID J. HANRAHAN, SR., President & CEO, Capital Bank of New Jersey
DANNY J. KELLY, President & CEO, Hometown Bank of Alabama
ARVIND A. MENON, President & CEO, Meadows Bank
MARY ANN SCULLY, President & CEO, Howard Bank
JOHN M. TOLOMER, President & CEO, The Westchester
JOSEPH W. TURNER, President & CEO, Great Southern Bank
LEN WILLIAMS, President & CEO, People's Intermountain Bank

STAFF PRESENT:

RUTH AMBERG, Assistant General Counsel, Legal Division
LISA ARQUETTE, Associate Director, Division of Risk Management Supervision
RYAN BILLINGSLEY, Corporate Expert, Division of Risk Management Supervision
CHAD DAVIS, Deputy to the Chairman for External Affairs
DOREEN EBERLEY, Director, Division of Risk Management Supervision
DIANE ELLIS, Director, Division of Insurance and Research
GEORGE FRENCH, Acting Deputy Director, Division of Insurance and Research
MATTHEW GREEN, Associate Director, Division of Insurance and Research
M. ANTHONY LOWE, FDIC Ombudsman
JONATHAN MILLER, Deputy Director, Division of Depositor and Consumer Protection
RAE-ANN MILLER, Associate Director, Division of Risk Management Supervision
PATRICK MITCHELL, Deputy Director, Division of Insurance and Research
MARK PEARCE, Director, Division of Depositor and Consumer Protection
ROBERT STORCH, Chief Accountant, Division of Risk Management Supervision
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(9:02 a.m.)

CHAIRMAN MCWILLIAMS: Oh, good morning, everybody. So, I am Jelena McWilliams, I am the incoming Chairman at the FDIC, and this is my first council meeting.

I am thrilled to be here. I am thrilled to have you here. I spent a little bit of time at the Federal Reserve and there was a bank advisory council similar to this one, that one that provided incredibly valuable perspective for a regulatory agency.

So I was very pleased when I came to the FDIC to learn that we have a very robust process here. We have great members on the council, as well. And the feedback we get from you enables us to understand what's going on in your region, in your areas, in the banking industry as a whole, and, specifically, with respect to community banks.

So I am just really happy to be here today and to meet you and greet you to what is my
first meeting. And I think you are the only one who is newer than I am to the council. The rest are more experienced than us, but Marty will make the introductory remarks and then we can start on business. But welcome, everybody.

DIRECTOR GRUENBERG: Well, thank you, Jelena. I promise to be brief. Let me just say that this committee was actually started when Sheila Bair was chairman of the FDIC, and then was continued when I became chairman. And for the committee to meet today under the leadership of our new chairman I think is really a very positive statement about the particular responsibility that the FDIC has as lead federal supervisor for the majority of community banks in the United States.

And the commitment of this agency to sustain a strong community bank sector in the U.S. financial system, frankly, from our perspective, is very much in the public interest to have the strong community bank sector in the United States.

And I think this committee, in some measure, symbolizes this agency's obligation and
commitment in that area. And I think it's also fair to say, as Jelena pointed out, this committee has proved exceptionally valuable to the work we do. It really is a vehicle for us on a regular basis to engage with community bankers. We tell you what we're doing, and we get feedback from you in return. And there's been a lot of value to that, and I think it's impacted the work we do in multiple ways.

So, let me say I really view it as a very -- as a statement, the continuation of this committee is a statement of the FDIC's commitment to community banking. And I'm really very pleased that our new chairman is, in effect, institutionalizing this committee as part of the work of the FDIC. Thank you.

CHAIRMAN MCWILLIAMS: Thank you. All right, we can start with the legislative update, please.

MR. DAVIS: Okay.

CHAIRMAN MCWILLIAMS: And actually, can I just make the introduction real quick? So,
Chad Davis is Deputy to the Chairman for External Affairs. He just started about a week and a half, two weeks ago almost?

MR. DAVIS: Week and a half.

CHAIRMAN MCWILLIAMS: Week and a half ago. So he is slightly more senior than you and I. Still slightly more junior than I am at this job. And Chad and I worked together on the Senate Banking Committee on different legislation. And he then worked with the Federal Reserve.

So we snagged him from the Federal Reserve. And his job is going to be exactly this type of an outreach effort that the FDIC engages in to understand what's going on with our banking industry and our regulated entities. So, thank you, Chad.

MR. DAVIS: Thank you, Chairman McWilliams. We thought we'd begin this morning by providing the committee with a summary of the Economic Growth, Regulatory Relief, and Consumer Protection Act, which was enacted on May 24th.

I thought it would be appropriate to
focus on some key aspects of the law and its impacts on community banking.

Ruth Amberg, Assistant General Counsel in our legal division, will begin the discussion. Rae-Ann Miller, who is an Associate Director in the Division of Risk Management Supervision, will touch on issues such as examination frequency, reciprocal deposits, and appraisals.

Ryan Billingsley, corporate expert on capital markets, will talk about the impact on the capital rules as well as the Volcker Rule.

Bob Storch, the FDIC's Chief Accountant, will touch on Call Report matters.

And lastly, Jonathan Miller, Deputy Director in our Division of Depositor and Consumer Protection, will discuss issues related to the Home Mortgage Disclosure Act, the qualified mortgage rule, and escrow requirements.

I'll now turn the program over to Ruth who will kick things off.

MS. AMBERG: Thank you, Chad. And good morning, everyone.
So, as Chad said, our panel today is going to be discussing the Economic Growth, Regulatory Relief, and Consumer Protection Act. And as he noted, it became law on May 24th. The act includes a number of provisions that may be of particular interest to this committee.

Some key provisions of the Act were addressed by the FDIC, the OCC, and the Federal Reserve Board in an interagency statement which was issued last Friday. That interagency statement is in your packets. It's also on the FDIC's website.

The statement sets forth some of the positions that the agencies are going to be taking in the interim until the agencies have a chance to amend our regulations to incorporate changes to the various statutes that stem from the new law.

So, for example, the statement covers, among other matters -- these will be discussed more by our experts here -- it will be discussing the increase in the threshold for eligibility for an 18-month examination cycle for qualifying banks. And that threshold, as you know, had been $1 billion
in total assets and now has been raised to $3 billion.

The statement also covers the plans for additional actions, such as for implementing the reduced Call Report requirements for the first and third quarters for certain banks.

It also covers the exemption to appraisal requirements for qualifying rural transactions, a. And the changes to high volatility commercial real estate.

Furthermore, the Act changes the scope of the coverage for the Volcker Rule and the treatment of certain municipal obligations as high-quality liquid assets for purpose of the liquidity coverage ratio rule.

And basically, as I said, it sets forth the interim positions that we're going to be going over while we work on amending our rules and take other actions to implement the Act.

So, you'll also find in your packets, and on our website, a financial institution letter that we issued about the Home Mortgage Disclosure
Act. So, that's something that Jonathan is going to be discussing, as you noted.

So, because Chad has already introduced the panel, I think we'll get started with them. And then after each presentation we'll have some time for questions and discussion and see how we get through.

So, Rae-Ann, do you want to --

MS. MILLER: Sure, I'll start. Thanks a lot, Ruth. So, I'm going to talk about exam cycle, appraisals, and reciprocals. And, as Ruth said, I'll pause if anybody wants to ask questions.

So the new law, and we call it around here S-2155, because the long name is kind of hard to say and it sounds a little like EGRPRA when you use the acronym.

But, basically, the new law automatically raises the eligibility threshold for an 18-month examination cycle for institutions with assets from $1 billion to $3 billion. And that's provided that they're well managed, well capitalized, not subject to an enforcement action,
and not subject to a recent change in control.

So what we're talking about here are the 1-rated institutions that's automatically affected. It also authorizes the agencies to adopt regulations to do this same change for essentially 2-rated institutions. So it's sort of the same deal, that they have to be 2-rated, they have to meet the other qualifying criteria of being well capitalized, not subject to an enforcement action, not subject to a change in control.

So, at this time, we're sort of discussing amongst the agencies, since this would require an action on our part, what's the best way to move forward with that.

We'd also point out, it doesn't affect folks in this room, but we do have some foreign branches that this also affects.

And another important thing is that the law gives us a great deal of latitude to authorize the 18-month threshold. And the flip side of that is to require institutions to still continue on the 12-month cycle. So it retains our authority to do
that.

So, that's the exam cycle. Appraisal exemption. So, this one deals with transactions in rural areas. And so, it's effective immediately. And certain real property in rural areas are exempted from the appraisal requirements that are set forth in Title XI of FIRREA.

So, this applies to transactions under $400,000, it applies to properties located in rural areas, and the rural area definition is the same definition that's used in Reg Z.

To get this exemption, the mortgages have to be held in portfolio, and the following conditions have to be met. So, I have to read these because I can never remember them, but: not later than three days after the consumer receives the closing disclosure required under Reg Z, the mortgage originator or its agent, directly or indirectly must have, number one, contacted not fewer than three licensed or certified appraisers on the mortgage originator’s approved list in the market area and documented that no state-licensed
or certified appraiser was available within five business days. And that's beyond the customary fee. So maybe you could have gotten somebody but had to pay way out of the range, but that doesn't count.

So, the exemption, again, we have pretty wide latitude from the supervisory perspective. It doesn't apply if we require an appraisal for safety and soundness reasons.

The exemption also doesn't apply if the loan is a high-cost mortgage. And if you remember, Dodd-Frank Act revised TILA to define what a high-cost mortgage is, and that sort of overrides the appraisal regulations when a high-cost mortgage is in place.

So, again, we're sort of looking at this right now. It's effective immediately. But we're looking at our appraisal regulations to see whether we need to do some conforming regulations.

Those two conditions are pretty specific and aren't currently, obviously, addressed in our regulations, so we'll need to take
a look at those.

And then moving on to reciprocals, again, effective immediately, institutions that are well capitalized and have a composite condition of outstanding or good, and so that means a one- or two-rated institution as of their last examination, or that have obtained a brokered deposit waiver from the FDIC, don't have to report reciprocal deposits as brokered on their Call Reports.

So, as long as reciprocal deposits don't exceed a certain cap, and the cap is defined as 20 percent of the institution’s total liabilities or $5 billion, whichever is less.

So, the exception is also available to IDIs that are not well capitalized and not in outstanding or good condition.

But the qualifying reciprocal deposits for these institutions would be capped at an average of how many reciprocals were held during the last four quarters, since the IDI was well capitalized or was rated a two or better. Or the
general cap, whichever is less. So they could be subject to a more stringent cap.

Since most community banks fall within this limit, most reciprocal deposits will accordingly no longer be treated as brokered deposits for the Call Report. Reciprocal deposits that exceed that amount will be considered brokered deposits.

And, one other limitation here, which is a very important one, is that the exemption does not apply when funds have been obtained through an agent, either an agent institution or traditional deposit broker or some other third party.

Also important is that less than well capitalized institutions qualifying for this exemption are still subject to the rate restrictions. So any deposit that is obtained after a bank falls below well capitalized is subject to those rate restrictions. Reciprocals are no exception.

And, again, these provisions are effective immediately. We're looking to see
whether we need to actually make any conforming changes to our brokered deposit regulation.

Unlike appraisals, brokered deposit is our regulation, not an interagency regulation. So I think I will stop there and see if anybody has any questions. Okay.

CHAIRMAN MCWILLIAMS: Any discussion? Okay.

DIRECTOR GRUENBERG: Wait a second, I'll ask --

CHAIRMAN MCWILLIAMS: You made everybody speechless.

(Laughter)

MS. MILLER: So exciting.

MS. AMBERG: All right, so, well, if you think of something, we'll have time later. So, Ryan, do you want to go on to the Capital and Volcker provisions?

MR. BILLINGSLEY: Sure. So let's talk a little bit about Capital and Volcker. I will talk about two capital issues in the Act and then will briefly touch on Volcker.
So I'll start with Section 201 entitled, Capital Simplification for Qualifying Community Banks, otherwise affectionately known here as the Community Bank Leverage Ratio.

So, I'm going to briefly describe kind of what it says. And then I'll try to sort of head off some questions that we've received already, to the best of my ability. I can't answer everything.

So, this provision of the Act applies to banks with consolidated assets less than $10 billion. And there's also a risk profile consideration.

The Act states that the banking agencies may determine that a bank, less than $10 billion, is not qualifying based upon its risk profile. And the Act outlines what we are supposed to look at when we make that determination.

And those things include, one: 1) off-balance sheet exposures, two, 2) trading assets and liabilities, three, 3) total notional derivative exposures, and number four, 4) kind of a catchall,
it says, other factors as the banking agencies may
deem appropriate.

The leverage ratio is required to be set
between eight and ten percent. And the ratio would
be defined as tangible equity divided by average
total consolidated assets.

A banking organization that chooses to
use this framework would be deemed compliant with
all of the capital requirements. So that has
implications for things like Call Report
simplification.

You can imagine a bank that looks to use
this, not having to fill out the RC-R schedule
today.

The Act also instructs the banking
agencies to sort of work or consult with the
applicable state banking supervisors, which we
will do.

Just real quick, a couple of questions
that we've already received, which I don't think
I can answer but just to let you know that these
are things that are sort of top of mind here.
So the Act says, tangible equity divided by average total consolidated assets. Well, one question is, “What do you mean by tangible equity?”

One can think of several different definitions for that. So, we are working on that, and that's going to require a rulemaking.

The other wrinkle is the Act requires a ratio between eight and ten. Well, that's obviously a little bit of a range there.

I don't have an answer for you about today, where we're going to land on that, but that's something we're thinking about, as well.

And then the risk profile considerations, we're thinking about those, as well. They obviously have implications for applicability of the ratio for banks under $10 billion.

So, let me stop on that one now and see if there is any questions on the community bank leverage ratio before I go too far.

MEMBER HANRAHAN: I have a comment not
a question, Ryan.

MR. BILLINGSLEY: Sure.

MEMBER HANRAHAN: I urge the corporation to consider the bottom end of that range, the eight percent end of that range, as it sets that standard.

Madam Chairman, I listened to your testimony during your confirmation process and I was very heartened to hear your emphasis on community banks, the need to slow the rate of the decline of the number of community banks in the country.

And fostering more de novos is one way to do that. I think the easier and more efficient way of doing that is slowing the ones going out the back door who are choosing to sell.

And for those of us who run stockholder-owned banks, our primary objective is to generate a return for our stockholders. The idea of selling naturally becomes more attractive if we can't generate satisfactory returns on equity to our own stockholders.
And one way of doing that is leveraging our capital. And an eight percent ratio is going to be much more conducive to us generating returns that really cover cost of capital for our stockholders.

And I think that while the Corporation might, well, by nature there is some additional level of risk, the more you leverage your capital. At the same time, if it's the FDIC's objective to keep as many community banks alive in the country as possible, allowing us to leverage capital, allowing us to generate the sort of returns we need to for stockholders and, therefore, remain independent, goes a long way to keeping the maximum number of community banks running in the country.

CHAIRMAN MCWILLIAMS: Thank you. Thank you, Dave. That's actually a very valuable insight for us, thank you. Anybody else?

MR. BILLINGSLEY: Okay, moving on. So the next item for me is Section 214, titled, Promoting Construction and Development on Main Street, otherwise known as High Volatility
Commercial Real Estate.

So, the Act provides a definition for HVCRE ADC, for purposes of the risk-based capital rule. It can effectively, sort of supersede the existing regulation.

And I know there was a proposal that we put out that included definition of HVADC. It kind of supersedes that, as well.

The interagency statement that went out on Friday provided some guidance for how banks can categorize HVCRE on their Call Report. So let me just summarize that really quickly.

It basically says the banks are permitted to use the Act’s definition of HVCRE when they report in the second quarter.

For Call Reporting purposes, it's not an obligation to do that. If you feel you don't have the information or otherwise don't feel comfortable, you can continue to report on the regulation’s definition, which is perfectly fine.

And again, it will be a best efforts basis, realizing you may not have the best
information today.

So that's sort of the interim step for application of this provision of the Act. Obviously, we will have to go back to our regulations, sort of a different rule, to make sure that it aligns with the Act.

We've gotten a lot of questions about specific terms within the Act’s definition, like, “What do they mean? How would you like us to apply that?” At this point, we have to sort of wait, -- think through that with the other agencies for the rulemaking process to do that.

So, I think it's, at this point, it's just a best efforts basis to apply the definition as you see appropriate. Vis-a-vis the Call Report until we sort of iron out those details. So I will stop there on the HVCRE, . If there are any questions, I'm happy to address them.

MEMBER TURNER: So, what are the differences between the new definition and the old definition?

MR. BILLINGSLEY: There are a lot.
So, I can point out a few.

So, the new definition in the act states that an HVCRE exposure must be secured by land or improved real property. That's sort of a difference from the current rule.

The new definition in the act states that the credit facility sort of primarily finances or refines the ADC of real property. That kind of aligns with the HVADC definition that we proposed, but not with the existing regulation.

There are some exemptions in the Act for things like cash-flow generating properties, income-producing improved real estate. So, think of improvement loans. The use of improvement loans to an income-generating property, we might extend a construction loan.

And then there is, in the existing HVCRE definition, there is a requirement that there be 15 percent contributed capital. I think you're all familiar with this one.

The Act allows the appraised value of land contributed by the borrower to count toward
that 15 percent. So those are some of the key ones. And again, we'll work through all the clarifications, if necessary, through the rulemaking process. Anybody else?

MS. AMBERG: Can you repeat all that?

(Laughter)

MR. BILLINGSLEY: There will be a test later. So, the last thing, this will be quick, is the Volcker Rule.

So, the Act effectively exempts IDIs or affiliates of IDIs with total consolidated assets of $10 billion or less and trading assets and liabilities of five percent or less than total assets from the Volcker Rule.

The only caveat is that if you're controlled by a larger institution you have to continue to apply the Volcker Rule. I think that one is fairly straightforward.

The interagency statement indicates that we're not going to enforce the Volcker Rule. The -- 2015, found the Volcker Rule in a manner inconsistent with the statute, so it effectively
means that community banks under $10 billion are
exempted from the Volcker Rule.

I think that one is fairly straightforward. Any questions on any of that,
I'm happy to address it.

MEMBER SCULLY: I have a question.

Any sense of how many banks, under $10 billion, are
engaged in those kinds of activities?

MR. BILLINGSLEY: I think today the
five percent, I'm assuming you're referring to the
total trading assets and liabilities of five percent?

MEMBER SCULLY: Yes.

MR. BILLINGSLEY: Yes. I think today
the answer is, if you're a community bank under $10
billion, that five percent trading asset and
liability sort of prong doesn't matter. It just
kind of creates like a, maybe an up or down of what
you could do to maintain exemption, if you will.

MEMBER SCULLY: Yes, my sense is that
the Volcker Rule is appropriately, of a much
greater concern to non-community banks than to
community banks. So it's good to know that but I don't know how many banks are engaged in that kind of activity or now will be engaged.

CHAIRMAN MCWILLIAMS: Oh, interesting question.

MEMBER SCULLY: It would just be interesting to know as you follow it --

MR. BILLINGSLEY: Sure.

MEMBER SCULLY: -- to see if it does make a difference in the behavior of --

MR. BILLINGSLEY: Absolutely.

MEMBER SCULLY: -- the organizations.

CHAIRMAN MCWILLIAMS: And, Ryan, you have a number, I think, at least the neighborhood, for the number of names that would be excluded?

MR. BILLINGSLEY: It's effectively all of them under $10 billion, so it's a little over 5,000.

CHAIRMAN MCWILLIAMS: A little over 5,000, that's right.

MR. BILLINGSLEY: But, there's a few under that that may be affiliated with a much larger
institution. But, yes.

MS. AMBERG: Anything else on capital or Volcker? Okay, Bob, you’re going to talk about the Call Report.

MR. STORCH: Okay, thank you, Ruth. Section 205 of the Act, I’ll give you the complete name like everyone else has avoided it.

(Laughter)

MR. STORCH: Come up with whatever acronym you want for it I suppose. Section 205 directs the federal banking agencies to issue regulations that allow for a reduced reporting requirement in the Call Reports for March and September for covered depository institutions.

And the law defines covered institutions as insured depository institutions that have less than $5 billion in total assets and satisfy other appropriate criteria established by the agencies.

As you may know, the FFIEC and the banking agencies introduced a streamlined FFIEC 051 Call Report in March of 2017 for eligible small
institutions as part of the FFIEC's community bank Call Report burden reduction initiative. And for that purpose, eligible small institutions, generally are institutions with domestic offices only, and less than $1 billion in total assets.

Those institutions have the option to file the FFIEC 051 report form or to continue to file the otherwise applicable FFIEC 041 report form.

The streamlined FFIEC 051 Call Report already has embedded within it, reduced reporting requirements in the first and third quarters for about 200 data items in the entire report. And for the first quarter 2018 Call Report, about 76 percent of the approximately 5,000 eligible small institutions chose to file the FFIEC 051 Call Report.

Prior to the enactment of the new law, the FFIEC, through its Task Force on Reports, have begun exploring alternatives for expanding FFIEC 051 eligibility beyond the initial $1 billion asset size threshold. And this effort included the
review of Call Report data submitted by institutions with more than $1 billion in total assets, that could serve as a basis for a proposed FFIEC 051 eligibility criteria for certain larger institutions.

So, some of the groundwork to support the rulemaking that's required by Section 205 has already been in process.

So, if we focus on the $1 to $5 billion asset size range, which is the size limit specified in Section 205 as I mentioned, there are currently about 530 institutions in that size range that a reduced reporting requirement could potentially apply to, because those banks currently are filing the FFIEC 041.

Since Section 205 was enacted, the FFIEC Task Force on Reports has begun interacting with the agency's legal staffs in terms of possible implementation issues that would need to be considered in the rulemaking process.

The Task Force on Reports, in consultation with the various users of Call Report
data within the FFIEC member entities, will also be considering how the reduced reporting requirements currently in place in the FFIEC 051, can be extended to the additional institutions, while continuing to meet the agency's critical data needs and any existing data reporting requirements mandated by other laws.

Ryan mentioned the Section 201 of the new law that provides for that community bank leverage ratio for qualifying community banks. And that has the $10 billion size limit, whereas the Section 205 reduced reporting requirements applies at, up to the $5 billion size limit.

So there's a partial overlap between whatever potential reduced reporting requirements there may be for community bank leverage ratio purposes and Section 205.

So, one of the considerations going forward for the agencies, with the Section 205 rulemaking and the proposed additional reduced reporting requirements, will be the need to ensure the appropriateness of reporting frequency for
those Call Report data items that working with the capital policy staffs are determined to be needed to assess the risk profile, the risk profile considerations that Ryan mentioned, to determine which institutions under $10 billion should be qualifying institutions for community bank leverage ratio purposes.

And with that concluding, sort of tie into another section that Ryan covered, I'd like to open up to discussion or your questions.

MEMBER TOLOMER: I think it's been helpful that you've reduced a little bit, but the reality is, for a community bank that's really just a community bank with a very simple straightforward approach to business, it's still an 86, 87 page report.

It has 15 pages on capital and our capital isn't really complex because we're not utilizing derivatives and the like. So I'd like to see more work done for real true community banks to reduce, it takes three days.

I asked my CFO of our bank and he said,
we've got a very experienced controller, takes him two days to do this work, and then it takes him another day to do it. -- to review it and to post it.

So we're talking about three full days to report information that's available. We're sensitive that you want information, that's great, but streamlining it at 88 pages isn't streamlining it. I think I'd like to see more done for the community bank that really is not involved in different types of businesses, we're different.

And it's a burden. And I think for banks that are even smaller than our bank, it's even more of a burden. And I know that some of my colleagues on the Committee feel strongly that way, as well.

So, just it's input, I'd like to see for community banks, even more work done to reduce the amount of work that is required.

MR. STORCH: Yes, I would point out that the, actually the 051, with the reductions that were put in place, is down to like 61 or 62
pages. It's still a lot of pages.

MEMBER TOLOMER: Right.

MR. STORCH: Fifteen pages of that, as you suggest, is the regulatory capital.

MEMBER TOLOMER: Right.

MR. STORCH: So, to the extent your institution would be eligible, after the rulemaking process is completed for the community bank leverage ratio, arguably, what, it would be two items maybe instead of 15 pages. So that would be a big savings.

And I think the FFIEC Task Force on Reports recognizes that that's probably the biggest area where burden reduction could be achieved, but it depends on rulemaking. But we're not going to sit on what we've already done so far.

MEMBER TOLOMER: Okay.

MR. STORCH: There is recognition that we need to consider what additional burden reduction there can be beyond just the capital, to satisfy what Section 205 asks for.

MEMBER TOLOMER: Okay.
MR. STORCH: And any proposals for reduced reporting, do go out for industry comment. And we do consider the comments we receive.

MEMBER TOLOMER: Okay.

MEMBER SCULLY: Yes, I'm just going to kind of echo what David said in this light of how many pages will be eliminated if we choose the simpler leverage ratio.

I think since any of us that have, certainly institutional investors or shareholders interested in a return, a number of us certainly, we are strongly considering not taking that simplicity leverage because we feel that we can better manage our capital if we stick to the risk-based formulas.

So, I wouldn't necessarily anticipate that a lot of people will rush to that simpler ratio because simpler, if it's inefficient for our investors, isn't necessarily the best thing.

MR. STORCH: I think it would be interesting to know as well, from your investor perspective, whether the level of detail that's
required now, in schedule RC-R, if you opt to continue that path, whether there could be some, even reduction, less frequent full reporting there, but would still meet the needs of your Board and your investors.

MEMBER SCULLY: That's a very predictable response.

(Laughter)

MEMBER SCULLY: It's going to be very helpful. I mean look, 15 pages of anything just raises the probability of a mistake or an error somewhere along the way. So any sort of reduction in the theme of all of this, in paperwork, is going to be helpful.

But I would just caution that I think a lot of smaller banks are going to choose not to take that simpler ratio. Because the risk-based ratio, while its complicated, provides you with more of a proactive opportunity to manage your capital. By choosing how you would allocate your assets.

MR. STORCH: Not to put you on the spot,
this is just myself asking personally --

MEMBER SCULLY: Okay.

MR. STORCH: -- would there be any benefit to sort of doing a side work paper calculation of the risk-based capital under the standards to provide your investors, even if you opt for the community bank leverage ratio, for Call Report and other purposes?

MEMBER SCULLY: No, probably not. I mean, that's work that we're all doing right now anyways. --evaluating whether this is a practical opportunity or just a theoretical opportunity.

So, it's appreciated that it's suggested but, no, I don't think it would be a meaningful aid.

MS. MILLER: Hey, Bob, can I pipe in one second, because I think Mary Ann raises a good point, is there is more users to the Call Report. You know, your shareholders, analysts whenever we cut items or change items, public analysts, you know, we hear from them.

And another thing is, the stuff I was
talking about, about exam frequency, that 18 months is not guaranteed. I mentioned, we have lot of flexibility to not grant that.

Well, one thing that we do is we look at the Call Report and we try to analyze, what has been in the changes in the institution since the last exam to determine whether or not to extend that exam cycle. So it's sort of a balance.

Understanding your point, John, about cutting burden, but it is also a tool that we use to make other decisions.

MEMBER DAKRI: Do we have numbers of how many banks are actually using the short-term Call Report?

MR. STORCH: Yes. There are about 5,000 eligible institutions from March, at 76 percent. So it's like in the 35, 3,600. That's just a quick, from what I recall, seeing the data.

The ones that are not anecdotally, from what we've heard, and this may not be, the universal reason is, the banks that are getting close to the billion-dollar threshold and they don't want to go
to the 051 and then have to very soon go back to
the 041. They want to keep their reporting systems
in place.

Or they're part of a larger
organization that has to file a consolidated FR
Y-9C with the Fed. And the Fed wants, the banking
organization wants the detail from each
institution to roll up into the consolidated
numbers.

So those are a couple of the reasons
that we had heard individual institutions who are
otherwise eligible, chose not to file the 051 and
continued with the 041. But I'm sure there are
other reasons as well.

MEMBER DAKRI: And just a real quick
follow-up. Is there any plans to maybe extent
extend that short form to the other quarters?
Quarters 2 and 4.?

MR. STORCH: Well, the minimum
requirement on the section is the first and third
quarters. The agencies, through the FFIEC, did
try to reduce the overall level of detail that's
recorded.

So there were certain schedules that were entirely eliminated from the 051. And just some very high-level data to serve as sort of a red flag in a supplemental schedule was included in the 051 as a replacement for about five or six schedules that had previously existed.

So there was an effort to reduce overall reporting throughout the year, in addition to the about 200 items where we already have either semi-annual or annual reporting, again, to reduce some of the burden on institutions.

MEMBER DAKRI: Thank you.

MEMBER BAER PAINE: We actually are still using the 041 because the difference, time difference in the shortened form, really was not much at all. So for the consistency of the reporting it would be really nice, we're a $145 million bank, so it would be nice for us to take a look at, in that first and third quarter, really a true reduction in that Call Report, bringing it down to the balance sheet.
The RC, RI, RC-C schedules, just really simplifying those, those first and third quarters. Because at this point they're just not, the new schedules aren't practices that we have in place. So it didn't help us much at all.

MEMBER DONNELLY: You know, I would concur with that. We're in the same boat and same size and the value of the reduction didn't make a lot of sense. We didn't get much value out of it and maintain the same level or maintain the same throughout each quarter.

I think it does provide a value to us internally so the reduction didn't really do much at all.

MEMBER TURNER: I want to go back. I think, Ryan, you talked about capital and the simplified capital.

One of the biggest changes to the risk-weighted capital rules, to me occurred, or to our institution, occurred a couple of years ago when you had to start including all of your unfunded commitments in your risk-weighted assets.
And so if you do elect this sort of simplified tangible asset, tangible capital, tangible asset ratio, obviously unfunded commitments would be completely ignored, right, for that purpose?

Or is there something where you're going to measure unfunded commitments for institutions, and if they're too large in relation to your asset size then you won't qualify for that?

MR. BILLINGSLEY: So that's a great question. T, this is where I dodge.

MEMBER TURNER: Okay.

(Laughter)

MR. BILLINGSLEY: So, you read the rate and know how good I am.

So, I talked about the risk profile to sort of carve out, if you will, in the legislation, it says that when we assess the risk profile we may deem a bank under $10 billion sort of, non-qualifying for the community bank leverage ratio based upon certain factors. And one of them is off balance sheet exposures.
MEMBER TURNER: Yes.

MR. BILLINGSLEY: So, there have been no decisions made, so I can't really address that directly. But we could, I guess is we could, consider those types of things when we do make that determination, but there have been no decisions made on that at this point.

MEMBER TURNER: Okay. And that would be true even if a bank is one rated, for instance, or you just don't know yet?

MR. BILLINGSLEY: I don't know yet.

MEMBER TURNER: Okay.

MR. BILLINGSLEY: It's a great question and it's one we're sort of wrestling with right now.

MEMBER TURNER: Okay.

MR. STORCH: And unfunded commitments are reported in a separate schedule for off balance sheet activities already today, separate and apart from all the risk weighting that has to be done for it.

MEMBER TURNER: Right. Right.

MS. AMBERG: Okay, anything else on --
MEMBER BOEKA: I will be responding with my colleagues here that the finance department decided to continue with the same as before. It was not worth making it, all those changes.

So, it didn't do the trick for, but on the other hand, we did not have a complaint. After so many years, it was pretty automated for a simple bank of small size.

MR. MILLER: All right, if there are no other questions we'll go to the fun stuff now.

(Laughter)

MR. MILLER: So, good morning. The focus of my presentation, as Chad and Ruth mentioned, is going to be on the title, some of the provisions in Title I of what I have been referring to as the Crapo Act, after the Senator who authored the provision, the bill in the Senate.

And so specifically, I'm going to look at Section 101, which is the minimum standards for residential mortgage loans which creates a new type of qualified mortgage.

And Section 108, escrow requirements
related to the mortgages. And both those are changes to the Truth in Lending Act.

And the Section 104, which is the changes to HMDA. Which I know will have a pretty big impact on many of the institutions that we supervise.

So let me start with the ATR/QM. -- the ability to repay QM rules.

So, under the ATR rule, the ability to repay rule, creditors must consider a consumer's ability to repay a loan according to its terms for all closed-end mortgage transactions.

The qualified mortgage designation was basically a simplified way, sort of a checklist of things you could do that would establish with a creditor right away that the loan meets the CFPB’s ability-to-repay test.

Within the, again, this has been sort of the pre-Crapo Act, although it continues to exist, a small creditor definition. To meet the small creditor definition, you had to have assets of $2.1 billion as of 2018. It was $2 billion in the
statute and then it’s adjusted annually.

That counts the assets of both the creditor and its mortgage affiliates. And you will have had to have sold fewer than 2,000 loans first lien originations.

You can, no limit on the amount of mortgages you could hold on your portfolio and retain a small creditor designation.

If you are designated as a small creditor, that gives you the benefit of making loans that qualify for QM status without the bright line deposit debt to income. The 43 percent debt-to-income test that's in the standard QM.

And small creditors that make at least one loan into a rural area get the rural designation. That allows them also to make balloon loans that were considered to be QM, which non-rural, non-small creditors do not get that ability.

And also, a much broader safe harbor for small creditors under the QM test. So that's the law and the regulation pre-Crapo.
Now, all that continues under the Crapo Act. But the Crapo Act really, it doesn't alter or supersede those regulatory standards for those types of qualified mortgages,. What it really does, so, practices that were in compliance prior to the Act passing are still in compliance.

What it does do is it adds an additional type of qualified mortgage. And for insured depositories and credit unions only. So this is, this does not apply to non-bank mortgage lenders.

And the key amendments, the key changes are that, whereas the old threshold was $2 billion as adjusted, the new threshold is now $10 billion. $10 billion in consolidated assets, not just the assets of the bank and the mortgage affiliates. -- the consolidated assets. --the loans.

So, if you are under $10 billion consolidated assets, you qualify for this additional type of qualified mortgage as long as the loans are in compliance with respect to pre-payment penalties, for which the points and fees do not exceed three percent of the total loan amount.
No NegAM or interest-only features. So the features that proved to be particularly problematic in the market as the crisis arrived.

And for which the bank has considered and documented the debt, income and financial resources of the consumer. And the loans have to be held on portfolio for the life of the loan.

So this frankly addresses one of the key concerns I think we heard from many community banks. And so, now any loan that they hold on portfolio going forward, will, as long as it meets those other underwriting criteria, will qualify as qualified mortgages.

And there are a couple of slides in your packet that might, this is what the cover looks like. It might just be worth taking a quick look at it.

So, in fact, the CFPB's old QM rule really covered most of the FDIC-supervised institutions already, as this chart shows you. Already about 2,300 of our banks already have less than $10 billion in assets.
The additional FDIC-supervised institutions that we think will now be eligible to make mortgages that meet, that qualify this for this new qualified mortgage category, is about 191. So, about 191 new institutions that made 1.2 percent of all reported mortgages by number, which is the first chart, and by dollar volume, which is the next slide that you see.

Obviously, a higher percentage of mortgages made by FDIC-supervised institutions. But in the market, as a whole, it's probably not going to be an awfully big impact. The rule had really already accommodated most community banks.

Certainly most of the community banks that we supervise. Although I think this does cover a few additional institutions and gives them a little bit more certainty.

Any questions on the QM?

So the next thing I want to cover briefly is escrow accounts. So, again, prior to the Crapo Act, the law and the regulation required the establishment of escrow accounts for all
higher-priced mortgage loans. HPMLs we call them. We really need an acronym for everything.

There were allowances for cancellation after a certain period of time and so forth, but there were key, for our institutions, key exemptions to the escrow requirement.

And that was, again, for small creditors operating in rural or underserved areas, designated as small rural creditors, they really, they were exempt from the escrow requirement as long as they met a certain other criteria. For example, they could not have an escrow program in place.

So, if they had not traditionally escrowed for mortgages, these institutions, they would not have to start escrowing for HPMLs as well.

If they did have an escrow program in place, then even though they were smaller institutions operating in rural areas they would have to continue to do that.

Under the Crapo Act, similarly similar to the QM and some of the other provisions you heard, the designation for small creditor goes from $2
billion as adjusts to $2.1 billion up to $10 billion. And again, the loan has to stay on portfolio.

There is one other distinction that we have not yet sort of figured out how it will affect the number of institutions for whom, for which this benefit is available.

Under the old rule, you not only had to be small rural but you also had the -- you didn't sell more than 2,000 first lien dwelling secured transaction, dwelling secured loans. And the criteria now is, you don't originate more than a thousand loans secured by a first lien on a principal dwelling.

So, I think that's just going to be an empirical question which we've not answered yet, how many of our institutions fit in that. I would say our typical, the typical FDIC institution originates somewhere in the neighborhood of 100 first lien mortgages a year.

So, I suspect the new provision will cover almost all our institutions. Just like the
MEMBER SCULLY: You know, the tricky think about qualifying, is dwelling secured though, is that you're going to pick up investor real estate as well as typical one to four residential.

MR. MILLER: Right. So the new rule is, the new law, the new provision is principal, principal dwelling. Right.

Now, HMDA, Home Mortgage Disclosure Act. So, the coverage under the pre-Crapo HMDA rule.

So, all IDIs that met the longstanding asset size, location, federally related tests and a minimum loan activity test, had to report HMDA. The IDIs that meet the origination threshold, now this was changed by the HMDA rule that went into effect in the first half of, the first part in 2017. The more detailed part went into effect the first of this year.

The threshold went up from just making one loan to at least 25 closed-end mortgage loans in the previous two years. This is the pre-Crapo
standard.

And the pre-Crapo standard also introduced a requirement for HELOCs, or open-end lines of credit of at least 500, in two years in a row. That change alone actually reduced the number of FDIC-supervised institutions reporting HMDA. Approximately five to 600 institutions.

The Crapo Act now goes much, much further. So, the Crapo law provides a partial exemption from reporting certain data fields to some of the insured depository institutions and insured credit unions.

So the threshold now goes from 25 first lien loans two years in a row or closed-end loans two years in a row to 500 mortgages. Closed-end mortgages in each of the two proceeding calendar years.

And for open-end lines of credit it retains the, it puts into statute the, what the CFPB had established in regulation that required if the institution originates fewer than 500 open-end lines of credit in each of the proceeding two years
the exemption applies.

However, it does not apply if for the past, the last two CRA evaluations the institution received a performance rating of needs to improve for CRA or, and that's for two cycles in a row needs to improve, or if in the previous, the last CRA evaluation, it received a performance rating of substantial noncompliance.

Both of those are pretty rare. And typically, if somebody is receiving a substantial noncompliance, for example, it's because one of the reasons is they're just not making mortgage loans and to get, needs to improve two cycles in a row, which is likely to be a three- or four-year cycle. It's just unlikely.

I mean, I would use the term de minimis. And I would not expect anybody here to really have to worry about that.

Note that the Act does not, this is an important point. I think there has been some misunderstanding on this. These new thresholds, the 500 loans, closed-end or open-end, just exempts
you from certain of the additional fields that were required. Reporting fields required in the Dodd-Frank Act.

You continue, if you're above the 25 and below the 500, you still have to report the other HMDA fields. And there has been some misunderstanding about that.

I will say parenthetically and editorially that we're grateful for that because, as the Deputy for Research and Policy, we like the data. And in fact, it's quite helpful to us in our supervisory, in our supervisory process.

So, now the sort of, to tap dance a little bit with my partner Ryan there, as clear as that sounds, we're going to have to wait for the CFPB to issue some rules to tell us exactly which fields have to continue to be reported and which fields do not.

There were some that are fairly clear, total points and fees, loan channels, such as retail or broker, credit score and so forth, that will no longer have to be reported. But, it's not as simple
as going back to the old fields because in part of its rulemaking, the CFPB changed around the old fields somewhat.

So, it's not clear how the act affects that. There were some fields that were added by Dodd-Frank that were not explicitly eliminated in the Crapo Act, so those may have to still be reported.

And then there were a couple of fields that the Federal Reserve, using its rulemaking authority, added to the list beyond what this original HMDA statute had listed. And it's not clear how the Crapo Act will affect that.

So, we are in touch with the FFIEC agencies are working together on this. It's really the CFPB's call, it's their rule.

They've promised to put out a, and we've put out a, as Ruth indicated, and again, in your package, we put out a financial institution letter which made clear that the CFPB is intending to put, do some rulemaking this summer to clarify some of these things so that people will understand, fairly
quickly, what has to be collected and what doesn't have to be collected.

   And just to close, if you'll turn to the last slide in our package, so you'll see this really has quite a dramatic impact on FDIC-supervised institutions, in terms of the number of institutions, and less of an impact in terms of the amount of lending it covers.

   So you'll see, so only 244 FDIC-supervised institutions will be required to do the full HMDA reporting going forward. They make about 71 percent of the mortgages by number and nearly 76 percent by volume.

   So we've reduced the burden on a lot of banks without necessarily losing a lot of the information that's valuable to us. Thank you.

   MEMBER KELLY: If I might speak to that. We're about 350 million, and we're a classic community bank. We loan on houses and cars. And we are dangerously close to 500.

   And I got some data from my compliance folks where we were doing 26 fields per loan.
That's 117 fields per loan.

I realize that you like the data, but that's a lot of difference. And I'd really like to know what usefulness there is to that 90 fields or whatever per loan.

You know, when you're doing, I mean, we're at like 485 or something and we're doing everything in our power to describe the loan correctly such that it doesn't apply. But, anyway, no, we're not going to do that really.

But it's a number we watch real closely. And when I first saw the information I sent a text to my compliance person and said, "Hey, oh happy day," and she said, "Wait just a damn minute—"

(Laughter.)

MEMBER KELLY: -- not such a happy day."

And I think the clarity is really critical. I mean, because 26 to 117 makes a material difference in a bank our size.

MR. MILLER: So just to be clear, the 26 to 117, it's not quite an apples-to-apples comparison. But, notwithstanding, I mean, we're
not the rule maker here --

MEMBER KELLY: I understand.

MR. MILLER: -- and it's not the law.

So --

MEMBER KELLY: I just say, put as much pressure as you can on the CFPB, let's get this thing straight so that we can start doing 26 instead of 117.

MEMBER HANRAHAN: I'm going to use Danny's oh happy day line in my question.

(Laughter.)

MEMBER HANRAHAN: So, Jonathan, as you know from an email I had with, email exchange I had with Mark a couple of days ago, what I thought was good news for my bank, which is nowhere near 500 loans, when we went over the HMDA changes with our compliance consultant, which is a national compliance consultant whose name you would recognize, they said, “Well, you have been relieved of the reporting requirements of the expanded data, but we're not so sure you've been relieved of the collection requirements of the report data because
what if you get a needs to improve or a substantial noncompliance in CRA, you better have that data to report.”

I'm curious to hear FDIC's position, please.

MR. MILLER: Well, let me start by saying thank you for letting us know in advance about the question and -- it gave us a chance to look it over.

(Laughter.)

MR. MILLER: From our point of view, we do not think the law requires you to collect the data if you don't have to report it. It's completely up to you whether you want to do it for whatever internal purposes, fair lending or other purposes.

As an exam matter we would not, we would just have nothing to -- if you're not reporting the data, we would not expect you to collect the data. And they just avoid getting a “needs to improve” two times in a row.

(Laughter.)

CHAIRMAN MCWILLIAMS: Jonathan, can
you maybe elaborate a little bit how we are going to look at fair lending issues in general if the data is not collected?

MR. MILLER: Well, again, remember all the old -- nothing changes for us in how we do any of our exams pre-2018 because there were no additional data fields in pre-2018, so we'll still have the old data.

We'll still be collecting the old data, and we'll still be doing the same kind of analysis we have always done.

So, for example, if there is a red flag on pricing, so there is an indication based on the old HMDA data, I'll just say that term, that pricing, which does not include some of the fields that the new HMDA data includes that you would want to know, for example FICO score.

If there is a red flag, we talk to the bank. We collect the additional data on a case-by-case basis if there is a red flag, and then we do the analysis.

CHAIRMAN MCWILLIAMS: Does that
MEMBER HANRAHAN: Yes, that does, and your earlier comments did as well. We are going to DVR this webcast and show it to our compliance consultants, so you know.

(Laughter.)

MEMBER HANRAHAN: I will, since you brought up fair lending, Madam Chairman, I will make a general comment. We are really grateful for the relief that community banks got under S.2155.

One of the things that has been discussed over time that would also be of, I believe, material relief to community banks related to fair lending is the requirement that if FDIC observes an apparent violation of fair lending that it is obligated to refer that to the Department of Justice.

That seems draconian, and it has a chilling effect on our desire to treat consumers flexibly and perhaps make exceptions sometimes to loans, because once you make an exception for somebody then if you haven't made that exact same
exception to somebody else it's a compliance minefield.

I don't know if the requirement to refer apparent fair lending violations to Justice is a legislative matter or a regulatory matter. To the extent it is something the FDIC can do something about, that would be a material way to create some relief for inadvertent non-systemic fair lending violations.

MR. MILLER: So it is in the statute, it's in the law, and I would say we -- I think we understand that community banks, the strength of community banks is the flexibility that they have.

I think we encourage community banks to use that flexibility, but we just say to them monitor it because if you do start seeing exceptions, if you start seeing a systematic pattern in the exceptions that has a fair lending implication, then that's worrisome.

So I would also just say we have so few referrals as a percentage of our total exams that it's just useful to keep that in mind.
CHAIRMAN MCWILLIAMS: And there you see Mark behind Jonathan. He doesn't need the break at 10:15, so just feel free to grab him.

MR. DAVIS: So part of my role is the timekeeper. We do have about seven more minutes. I thought I would suggest if anybody wanted to move back up the panel as well, you know, pretty much I think over the next few minutes any question, relevant question, is fair game. So I just thought I would give people an update on where we stood time-wise.

MEMBER DONNELLY: Just a general question on the appraisals and the appraisers, and being from Kansas and then from also, not -- I'm not from western Kansas where there may be one or two people in the whole county not appraisers --

MS. MILLER: It could be an appraiser though, you don't know that.

MEMBER DONNELLY: We are finding that it's really difficult, and the timeframes that is really a short, trying to make a determination if you can find somebody, and you may have to call four,
five, or six counties away, which is further than all these states put together.

I think there has got to be some assessment as to the reality, what value somebody can bring from four, five, six counties away, which could be 150 or 200 miles, what value is that over the person who is there in that community making that loan, been there for 20 years, and understands the value.

I am just making a general comment because that is a significant issue we hear constantly from our small banks in Kansas, and it's getting worse instead of better.

Finding somebody who wants to be a certified appraiser or licensed or whatever rule you follow within your state and within the guidelines is not going to improve, and I make that statement as that I really think the FDIC ought to look at really, I hate to say loosening up, because we don't want to lose safety and soundness, that's not what the point is.

It's just a matter of fact there is
nobody out there to do it and to have too restrictive
of timeframes or when you have to move to do certain
things I think is going to be really difficult for
the small banks out there.

MS. MILLER: Yes, I mean we talk to a lot
of, and thanks for that, because we do talk to a lot
of rural bankers. In fact, we did a listening
session at the end of last year.

We did not go to Kansas, but I had the
pleasure of going to both North Dakota and South
Dakota in November.

MEMBER DONNELLY: It's the same thing.

MS. MILLER: And it was kind of cold.
But, yes, so we hear that, and availability is not
improving.

There is a few things, supply of
appraisers is sort of being depressed by the, I will
say one banker called it the guild-like nature of
the appraiser profession where you train your
competitors, so who wants to do that?

And if you are the only guy in that place
in Kansas, well then you've got it pretty good
because you can get all the work you want. So they talked about that and supply, and asked us to look at the balance of supply and demand.

And so I am going to talk a little bit later about raising the threshold, which we recently did on the commercial side which should provide some relief.

So if there is no demand for a licensed or certified appraiser to do that, then that is helpful. We can't do a heck of a lot about supply because that is a different industry that we don't regulate. So there is that.

You know, there are other things that we have talked about. There are waiver options in rural areas, you know, we've had one case of that. We did not, the Appraisal Subcommittee did not approve that, the case wasn't made, but certainly something that we are thinking about.

The provision in S.2155, it's written in an interesting way, and that's why I read it is -- it's hard to kind of understand, but I think it's trying to attempt to give an exemption to those
rural folks.

So if the property is located in a rural area you have to call three people, and then you get five days to try and say, “Well I can't find anybody in five days,” so I think it was an attempt to provide relief, but it's going to be challenging for us looking at it and figuring out what kind of regulations we will need to write, if any.

MEMBER DONNELLY: So in general on that assessment, if I have a loan today that I make and I use the exemption, three months from now I may have another loan on the piece of property right next door and I have to go through the same -- we already know because the environment has not changed, so it's a per-unit process versus an overall assessment of the environment, which that seems to be a little silly. Sorry.

MS. MILLER: No, I don't -- yes, I didn't write S.2155, but, yes, it's something we'll talk about later, too, about the overall thresholds and what is the appropriate balance.

You talk about safety and soundness,
another thing about when we said a threshold, it doesn't mean that the bank doesn't value the property, so stuff that happens underneath the threshold you should be getting evaluations, you should be knowing --

MEMBER DONNELLY: Sure.

MS. MILLER: But one thing when we write rules is we're not just writing for the good guys, you know, we have to write for everybody and make sure that safety and soundness is appropriate across the system.

So, very good points, ones we have heard in EGRPRA, on these outreach sessions, and certainly some of the briefings we have done for this group as well.

MEMBER DONNELLY: One more question. Jonathan, I would like to go back to your comment about data, we like data. On the HMDA reporting a thought, or your thoughts, on the differential between owner-occupied, where I am actually owning, versus a rental property, investor property. Our HMDA is maybe 20 percent
owner-occupied versus --

MR. MILLER: Oh, is that right, your --

so only 20 percent of yours is --

MEMBER DONNELLY: It's probably even

less than that. Whether there is a real person

living in it, and they are all real people, but the
differential, what does the Ccorporation see as a
differential when you are talking about data,
you're talking about hard data, and you're using it
for something, and I sure understand that.

MR. MILLER: So I think part of it is for

exam analytics, that is what's, you know, what are

the, are we seeing, you know, if there's a problem,
if there is a red flag is there really a problem
there, and the vast majority of the times it turns
out there is not a problem.

And the other is just to understand what

is going on in markets as a way of sort of improving
our supervisory planning and just understanding the
market so we inform ourselves better as to what we
need to be doing.

MEMBER DONNELLY: Well, I would -- my
comment is just that, and I know you don't make that rule, that's in another shop, if there is a distinguishing between those that would be a real burden reduction if there is some logic or if you could find some logic to share with the other agencies.

If you could distinguish between from where I sit on my side of the desk there is a significant difference between an owner-occupied property and an investor property.

Now the person in that is once the -- when I make the owner-occupied loan I am dealing directly with that individual. The individual who is in that house I am one removed when it's an investor.

So if there is other data you are collecting for that third party, if there is a reason, I don't know if that makes sense, and I don't know what that is, but I think if you would look at those and really separate the two I think the reduction of burden would be reduced significantly.

MR. MILLER: We'll take a look.
CHAIRMAN MCWILLIAMS: You know, this is your first meeting, right?
(Laughter.)
MEMBER DONNELLY: Does that mean I should shut up?
MR. DAVIS: Okay.
CHAIRMAN MCWILLIAMS: Taking notes.
MEMBER DONNELLY: Thank you.
MR. DAVIS: I have to wave the timekeeper flag. Thank you very much to the panel. We will take a brief break now. Be back in this room at 10:30, and we'll have a couple more panels for you at that point. Thank you.
(Whereupon, the above-entitled matter went off the record at 10:17 a.m. and resumed at 10:33 a.m.)
MR. DAVIS: Okay, I think we'll go ahead and get started.
CHAIRMAN MCWILLIAMS: See this is why I need a gavel.
(Laughter.)
MR. DAVIS: In our next session, we
would like to provide an update on other regulatory burden reduction initiatives. Our panel is from the Division of Risk Management Supervision.

We have Doreen Eberley, the Director, Rae-Ann Miller, an Associate Director who oversees the Risk Management Policy area, and Lisa Arquette, the Associate Director who oversees our Anti-Money Laundering Group.

They are going to discuss exam modernization and related standardized process for the FDIC to obtain imaged loan files electronically.

We will also have the opportunity to talk more about appraisals, and we will highlight reviews of interagency guidance as well as Bank Secrecy Act.

So I will turn it over to Doreen to get us started.

MS. EBERLEY: Okay, great. Thank you. So the four kind of initiatives that we are talking about here today, exam modernization, the interagency guidance review, the work on
appraisals, the appraisal regulation and regulatory relief there, and the Bank Secrecy Act, all are coming out of the EGRPRA review from last year.

So in the report that we submitted to Congress last March we said that we weren't done, we were going to continue our efforts to look at how we may be able to provide continuing burden reduction relief through the regulatory process through our examination processes.

So that's what we are talking about today, and I will go ahead and turn it over to Rae-Ann to kick us off.

MS. MILLER: Thanks very much, Doreen. So I thought I would start with exam modernization with this group.

We had talked about exam modernization I think in the Spring 2017 session, and we did a facilitated discussion and really kicked off the project because that's right about when we started, and we got a lot of great feedback from this group.

So just as a very quick background,
Doreen talked about the EGRPRA report, and we started this project, and say exam modernization, exam modernization is an interagency project through the FFIEC, and what we are trying to do is figure out ways to improve the efficiency and streamline the -- exam process really without sacrificing the quality of the exam.

And we are talking about safety and soundness exams for the most part here, although some of the principles we are talking about certainly could apply to other types, and we are talking about community banks as well, so just to take a step back there.

And in the EGRPRA process, the process was about our regulations and, you know, we published regulations for comment and had the outreach sessions that some of you participated in, but we also got a lot of comments about it's not just regulations but it's the actual process of the examination when you are on site and the communications that occur that also can lead to concerns about burdens amongst community bankers.
So we started this project after the EGRPRA report was delivered, and we started out focusing on three different areas, and, again, this is sort of in the safety and soundness realm.

So the first was reviewing exam practices and processes, and there we had a goal of, a particular goal of determining whether technology can be used to make the exam activities that we do already more efficient, and specifically, could we conduct more of the work that we do on an offsite basis?

Secondly, we reviewed the format of the report itself, and are there opportunities to improve the quality and usefulness of the reports?

And then, thirdly, we looked at the Uniform Bank Performance Report and related reports and data to see whether we could make them more informative, more user-friendly.

So we have a group that is made up of folks like me from the other agencies. I am the Chairperson of the group, and started, you know, staffing the project and overseeing these areas.
And we also linked up with a separate group that we have called the Task Force on Surveillance Systems, and they were already pursuing a track to improve the Uniform Bank Performance Report.

And I said something earlier about the Call Report, one of the things we do with the Call Report is it feeds into these surveillance systems that we use, and Chris was interested in what do we use the data for, and there is macro uses to see what is happening in certain areas, in asset classes, in changes in risk profiles in general, growth, but from a micro perspective, we look at institutions and see how they change in between examinations.

And so we have a number of early warning systems and surveillance systems, this group helps us with that and it helps standardize that process, but it does help in our exam scheduling and work that we do around assessing risk profiles.

So the project is long-term and multi-phased. Here we are over a year into the project, but we didn't want to wait to make
improvements till the end so we have kind of been
doing stuff on a flow basis.

So our initial step was getting
together, comparing practices among the agencies,
we sought some initial feedback from bankers and
examiners, and we definitely talked to this group,
as I mentioned, but we also spoke to individual
bankers, eight individual bankers, and about 50 or
so more through trade group associations.

They held the calls and asked questions
that we would be interested in, and we sort of
listened in.

So we got a number of themes from those
feedback sessions, and the most common theme, I
don't think you'd be surprised because I hear it
here, and the comment came from this side, but I
think it was Danny or maybe Mary Ann made this
comment about, you know, communications -- it
sometimes can be a black hole, I think was the word.
I hated that word, but, you know, we heard it again,
that sometimes bankers don't understand why we send
so many people to the bank, you know,. Who are all
these people, ? what What are they doing.?

Did you actually read the stuff that we
gave you beforehand, because it doesn't seem like
you did, -- this three examiners -- they are
laughing, see. But these are the things that we had
heard, you know, three people asked me the same
question.

And then what happens to the exam
report? Do we send it to the office? We are very
anxious, . We want to see what that says. You gave
me a preview, but you also said that the regional
office could change it, so we would like to know.

One of our bankers talked about how in
production you can track things along, you know, has
it gone into the factory, is it going down the path,
and suggested a process like that for us.

We like to think about the pizza making,
right, you know, . Are they adding the pepperoni,
? Are they putting it in the car, ? You know,
could there be something like that to track the exam
report was literally something that somebody
suggested.
So there was that, that was sort of the first theme. The second theme was we specifically asked the bankers and examiners about the benefits of moving more activities offsite, and both sides were very enthusiastic.

To a person, almost, except for one on the bankers, they really did value the onsite presence and having those conversations and being able to chat with the examiner who has been in many different institutions.

They talked about the benefits of having informal communication and understanding that, you know, if we talk about trends and things, it doesn't mean a direction to do something, but it's something that the bankers felt were appropriate.

From the examiner's perspective, they talked about picking things up. You know, if you are at a bank and you are trying to evaluate management or the way they do something, sometimes you just pick things up on the way the bank is operated when you are onsite.

So, we are not talking here about
completely moving everything offsite, that we find an extreme benefit of being onsite.

The third theme was sort of a lack of belief that we truly risk-focused our exams. And based on risk profile and business model, so John talked about being a plain, old, you know, community bank, we have community banks that have been around since the 1800s, and pretty much have done the same thing for many, many years, and so I mentioned that, hey, I am sort of a poky little bank in the middle of nowhere and yet you turn 60 percent of my loans every year, why do you do that, and so they felt that.

From the examiner's perspective, the examiners felt that we do a good job probably of scoping up, but could probably do a better job and giving them cover to do a more basic baseline, especially for those very low risk institutions. So I think that was very helpful to hear.

And I think another thing that we heard a lot about were complaints about the secured file transfer systems that we use, and ours is called
FDICconnect, but the other agencies have them, and we had a lot of comments about functionality and slowness and then there is nobody to call.

So we have all kind of done our own, we have our own system, so we have been at least trying to improve functionality on FDICconnect on the back end.

One of the things was that sometimes examiners were using it as a storage facility when it is a transfer facility. So having, you know, ten exams in there really will slow things down if you are trying to bring things over. So we think we have at least worked on some of that stuff.

We didn't hear much from bankers about the Report of Examination or the UBPR. Examiners have a lot of suggestions about those areas, but they weren't really viewed as burden issues for community bankers so I think that was where the community bankers were focused on.

So those were the themes in a nutshell. And so as we went through them we decided to focus on the ones that cause the most heartache for the
community bankers.

So at the end of last year we ended up sort of cutting loose the UBPR work. That group already was funded and already did their own work on the UBPR.

If you haven't looked at it lately, it's pretty interesting. They have added very useful graphical capabilities to the UBPR, which is hopefully much more helpful to you, and they are not done either. They are continuing to look at ways that they can continue to improve that.

And then in March we released -- to deal with that first theme of communication through the FFIEC we released a short press release and advisory to kind of deal with these communication and transparency themes.

And the release, we put it in your package, it sort of tells the public about the status of the project and the themes we have heard and basically indicates that the FFIEC principals are really committed to good communication and transparency in the examination process and that we
strive to be clear, timely, and transparent in our communications and that we are going to reinforce and reiterate this through internal guidance for examiners.

We talk about several broad principles about exam communications, and these are assisting community banks in preparing for the examination, and that's in terms of prior notification about space, staffing, and logistics, and, you know, we would expect examiners to be very clear about all of those things with our bankers.

It talks about tailoring the exam request list and scope to the unique risk profile and business model of the institution. That is something that we continue to work on here at the FDIC and continue to focus our examiners on that and are doing work about helping them understand what it means for banks to have different business models and different risk profiles.

And sometimes banks have different business objectives, you know, a. A mutual is going to be different than a stock, and helping
examiners understand those differences is very important.

    We talk about, you know, facilitating the secure exchange of information between bankers and examiners as efficiently as we can. We talk about keeping institution management informed of areas under review, providing lots of opportunities to communicate.

    I think it was in this group somebody said we love weekly meetings and every Friday we get together with the exam team and, you know, we raised that with some of the other bankers and everybody seemed to really like that.

    I say everybody, but there is one person who didn't want us there at all, but that was an exception.

    (Laughter.)

    MS. MILLER: And then, finally, ensuring that the examination results are clearly understood and establishing clear expectations regarding the items that the banks are expected to address.
And that's something, even though there weren't a lot of ROE comments, it's something that we have been working on making sure that actionable items are clearly identified in the exam report rather than having you, you know, go sort of hunt and peck through the report. So that is something that we have worked on here at the FDIC.

So this statement here -- exam modernization project, it's not, you know, super new and innovative. We didn't intend it to plow a new ground, but we intended it as a reflection of our current policies.

And then, sort of, to make sure that the bankers and the examiners understood that we heard your number one complaint about communication and that we are committed to doing a good job about it.

So the second theme was sort of the idea about moving more work offsite, and we compared notes on that as well, and we found out that currently we can and we do do some stuff offsite, . Where a bank is heavily a user of imaging we could do loan reviews, and sometimes not offsite, but
sometimes with a dedicated model -- dedicated model, dedicated computer with a password at the institution, but we definitely think there is more room to do more work in this area.

Loan review is a low-hanging fruit. It takes a lot of time, so about 40 percent of the exam time on average is spent on loan review. So this is where the loan imaging project comes in Chad mentioned. We call it Project FIVE here.

But in April we issued a notice to bankers, to servicers, anybody else who was very interested though our financial institution letter process that said we were going to be piloting a project for reviewing standardized loan file images offsite.

And then we followed that up with a call in May, and we did have a lot of servicers on the call who were interested in participating in this.

So Project FIVE stands for File Image Viewer for Examinations. I think Bob said we have to have acronyms for everything, so we call it FIVE.

And then, prior to the release to the
public, we did share the project specifications with the other agencies, so the idea is hopefully they'll find it useful as well and we can come up with some sort of a standardized loan file to review offsite, regardless of who the regulator is.

So we did that in May, that call, and we began piloting the process. We now have -- We finished our first institution and we've got another one lined up.

They are volunteers, it's not required. But we plan on doing a number of different, doing these with a number of different institutions so that we can kind of gather some lessons learned, and the idea is that at the end of this year we'll have what my friends in IT call a virtual symposium where we kind of talk about lessons learned and ways to expand this thing.

And I think really if we can get this right and if servicers choose to adopt it, it really has the ability to vastly expand the work that we do offsite and without compromising our efficiency or our effectiveness.
So regarding the risk focusing, and this is the thing where people don't believe that we risk focus, we did talk about best practices across the agencies, and we kind of came to the conclusion we all risk focus, we all really make an attempt to do it.

We all have different approaches to tailoring our exam procedures and this is largely because of the way we are structured.

You know, like the FDIC and the Fed we alternate exams with the state often for well-rated institutions and for states that have an appropriate program, whereas the OCC's they call it following themselves.

So their planning and their scoping tends to be a little bit different because of that. So we realized certainly at the FDIC that we could do a better job about documenting exam plans and scopes using available information to help scope.

And another important principle for us as managers is that we need to make sure we give examiners enough time to do the scoping properly.
So what we heard from you guys is you don't really understand about our risk profile, and we heard from examiners you don't give me enough time to sit there and understand the bank's risk profile and go through this stuff.

So we really think that giving them time to tailor the request list, understand the bank is important, that's something that is hopefully within our control.

And then just, you know, examiners need to be clear in scoping. They need to explain why certain procedures are being done. You know, this whole thing about, well, I'm this -- you look, we heard this a number of times, I am a little bank in the middle of nowhere, and I have had the same ten large loans and you look at the same ten large loans now for like seven years in a row.

So we need to explain, and if that's not necessary we need to scope that out, and if it is necessary then we need to explain why we are doing it.

And then I would say that, you know,
tailoring for risk, it doesn't stop at the end of the exam. We encourage and require actually examiners to communicate in between the examinations.

We talked about the surveillance systems and we want to make sure we understand whether things have changed.

And then I talked a little bit about on the fourth theme the actions that we have taken on the file transfer system.

So we have definitely worked behind the scenes on improving the flow, and we also have been working on some training for examiners and some handbooks for institutions and perhaps a video, you know. We have that video series on particular issues that are of interest to bank officers and directors, and are working on one on FDICconnect.

So that's sort of where we are with the project now. I could pause before going into other topics.

MEMBER TOLOMER: Yes, Rae-Ann, I think you have made a lot of progress and I can tell you
from my own personal experience, I guess it's now a number of months ago, a lot of what you just said actually happened and it was very smooth.

    MS. MILLER: Good.

    MEMBER TOLOMER: And the 18 months versus 12 months would be less of an issue because it was less intrusive, but it was more comprehensive because we had a meeting, . We went through the conversation about the bank and what has happened with the bank.

    Nothing got lost, what we uploaded, people read, you came onsite, you were prepared. You came out to talk to our people when you needed to for clarification, I had a weekly meeting with the examiner in charge, and so it was a very smooth process and we were able to fix things.

    If there was something wrong, we were able to fix it immediately. One suggestion while you are looking at this is, and nothing specific comes to mind, but let's just say a policy gets criticized for lack of clarity or something, . So we look and say, well, okay, great, you know, you
have commented, do you have kind of the blue ribbon
or a gold standard policy.

Oh, we can't give that to you, we can't
comment. No, no, you already have commented, but
maybe what the FDIC can do is create a database of
say two or three policies or procedures where we
might be criticized because, at the end of the day,
the CEO and the regulators want the same thing, .
They want a strong, profitable, vibrant bank, and
compliant.

So if you have those -- , wWhen we are
asked, oh, I need an accountant or I need a lawyer,
we don't give out one, we give out three names and
let the people decide who they want to work with.

If we were being -- aAnd these are not
major criticisms, -- but you have commented and said
you should enhance this, well give us the answer to
the quiz or show us two or three different options
that we could adopt and say, okay, does this work
for our business.

So it's not just a criticism, it's a
criticism, that's fine, I want to hear it, but here
are some other options, because we are of like mind, we want the same thing.

And so I would ask to figure out is there a way for you to, "you" the FDIC, to show us, hey, here is two or three options that you could utilize that would satisfy what we are looking for.

MEMBER DONNELLY: I would like to follow up on that, if I may, and I appreciate the comment, and I go back to data, and Jonathan is over there probably writing notes about we now, but --

MS. MILLER: We Millers stick together.

MEMBER DONNELLY: But it was early on and you talked about data and you utilized that data and if you are seeing trends, if we see that in advance, and you'd probably give it to us, you said some banker said, well, we gave you that three times, you didn't listen to us.

Well, bankers need to listen, too, and if you are sending this stuff out -- but a more focused or in advance laundry list of what I think he was talking about, here are the high points, here are the bullet points that we are seeing in industry
be prepared, and we can deliver that information to you more -- because you are seeing it, I mean you are gathering the data anyways.

And if you are seeing trends and directions and you want to know in advance what we are doing to tailor the exam down to more of a where are the stress fractures at so we can find them and fix them, if you are seeing it in advance, tell us what you need to look at and where you are seeing the stresses in the area.

We have it generally. I would think most banks would have that information to deliver it to you in advance. I hope that makes a little bit of sense.

MEMBER TOLOMER: Well, Chris, what we do differently, which I think gets to this information, is we meet every six months with both sets of regulators together.

So I go into New York City, I meet with the state and the FDIC office and tell them what's going on, and we do it every six months and so that they always have a sense or an understanding of what
is happening with our bank.

And when we were setting up for safety and soundness and we had the Q&A, or the discussion on the phone, it was all pretty consistent.

So the FDIC came in and they were pretty well prepared to understand what they were looking at, and that might be another way.

And I know that both sets of regulators, and, frankly, I like the idea of meeting every six months or so because I get a chance to say, okay, tell me where are the potholes out there, what do I need to know, what should I be avoiding, and so we have a very healthy dialogue to be able to operate the business, you know, the bank, on an ongoing basis.

I was just looking at it from a perspective of, you know, if you have a criticism, you see a lot more banks than we do, so if there is a criticism or a need for enhancement, could you be the resource since you see 5,000 banks to help us streamline that rather than to figure it out, put it in, and you come back in 18 months and say, oh,
that's not what we were looking for.

Hey, just give us the answer to the quiz and give us options.

MS. MILLER: I mean, for what it's worth, John, you are describing the very reason why we issue supervisory guidance --

MEMBER TOLOMER: Right.

MS. MILLER: -- you know, and what we expect and what we see and it's typically principles-based.

The only issue about your gold-plated thing that makes me a little bit worried is that we do get criticized if we put something out that is such a bright line, oh, you're going to hold me to that, or that perhaps we would be putting our stamp of approval, FDIC stamp of approval, on a private product. So that's only sense that I have there.

MEMBER TOLOMER: Yes. No, I understand that. You know, look, we are adults and so we understand that, and I'm not going to try to use it as a defense of well you gave me this information so, therefore, you can't criticize me,
I get that.

And we have to use our own candle power to really figure out is this the right thing for us or not. B, but it helps to guide whatever that enhancement suggestion is and, you know, we understand that we make the decision, what we put in is our responsibility, and we can't go back and say, well, you know, you told us.

That's -- I don't think that many would. Well, I guess there would be some that would do that, but, okay.

MEMBER BAER PAINE: I do think, to John's point, I do think that the opportunity that your examiners do have when they are onsite, and so I am just going to say this, and I have told Doreen and many people this many times, we have great crews.

The crews we work with are just wonderful, all our exam crews, whether it's compliance or safety and soundness or CRA.

But the opportunity that your examiners have is when they are onsite and they say, for
example, in your policy, maybe grab your appraisal policy or your credit guidelines or your IT or whatever it is, we would like to see this, this, and this, let's sit down and look through your policy.

This is, I would like to see this topic addressed in this area, I would like to see this topic addressed in this area, or even kind of helping through that, a little hand holding, but if it's being written down as a criticism really help us lay out -- They don't have to put the words in our mouths, but they have to give us the topic that goes in what they would like to see so then we can take off from there. I think that's helpful.

The other thing that I think would be helpful is, as you are talking about the data that you use to track, whether it is from the Call Report or UBPR or wherever you are getting that data for the tracking, the bank goes along, green light, green light, green light, yellow light.

When it hits that yellow light, that warning signal for you, is that an opportunity for you to reach out to the bank and say, "Hey, you hit
that yellow light?” And I don't know if you do that now, but --

MS. MILLER: We do.

MEMBER BAER PAINE: -- you know, that's something that before we get onsite you should take a look at.

MS. MILLER: We do. We have a number of those surveillance systems that trigger a reaction and the first reaction would be a call to the institution.

It could be growth, it could be liquidity changes. We've got asset classes that we look at, oil and gas, CRE.

MEMBER BAER PAINE: Okay. Thanks.

MS. MILLER: Great, thank you.

MEMBER DONNELLY: One final question, or just a comment on the value of an examiner coming into the bank. We value that. I hope it doesn't go away.

The field people in Kansas City are great and we value them coming in and utilize it as another tool and are we doing things right along
with our external auditors or internal auditors and I would just encourage that any way possible, keep as much of that open.

It is -- Sometimes I think it's an interference, there's just a lot of people there, but the communications are really important to me and to our shop to hear and a face-to-face conversation of really what's going on. So just a comment.

MS. EBERLEY: Yes, it's extremely important to us, too, and we want to just make sure that we are striking the right balance between how many people are we sending, how long are they saying, you know, so just enough to get what we need and to have the good communication, but not too much, and let's do what we can do offsite offsite.

MEMBER MENON: But, yes, I got to second that comment about trying to keep that onsite presence going.

MS. EBERLEY: Absolutely.

MEMBER MENON: But absolutely if there is a way we can reduce that timeframe because we've
got a safety and soundness exam coming up, I think it's scheduled for three weeks even though we upload a lot of the information through the FDICconnect.

I was wondering if there is a timeframe that you might see that reduced down to two weeks, ten days, or something of that sort?

And primarily because, you know, when you have 11, 12, 15 people show up, including the state, in our case it's a joint exam, and in a small bank it basically takes a lot of our conference room facilities and whatever else space we have got.

Not that we don't appreciate having them onsite, but if we can keep that to a lesser amount that would be helpful.

MS. EBERLEY: Okay. Yes, I think that's exactly what we are aiming for.

MEMBER MENON: Thank you.

MEMBER WILLIAMS: I would make a comment on that same point. Our last exam, again, went incredibly well, the interaction was phenomenal. We did the weekly meetings, not just with me, but with the whole leadership team and the
leadership exam team every Friday.

It was a phenomenal interaction. That we need to continue to keep going. A lot of feedback. And even to the point where, you know, I don't want to get anybody in trouble, but where, you know, I'd say tell me who has a good plan, he said, “Oh, you might talk to so-and-so, you know, give John a call at West Chester, they've got a pretty good program there.”

That's pretty helpful for us and then we get to, you know, you're not guiding us but you are giving an example of something you like and we've got a contact. I think that is good.

But then also managing the disruption is the tough thing. It's not the leadership interaction, that's phenomenal, it's some of the back and forth and finding and digging and we've sent it to you four times, here it is again, that's a little bit of internal disruption.

And I don't know how you manage that. If there is a way to digitally connect the information and have an exception list that comes
out once a week or something that we can figure out
together, but one-on-one critical managed
disruption, and I would add we had a three-week time
period as well but they were done in two and they
left a week early.

CHAIRMAN MCWILLIAMS: Don't tell him
that.

MS. MILLER: Yes. You know, I mean as
the disruption goes I mean it's disruptive for the
examiners, too, right. So I mean it's kind of a
win-win if we can do a better job in being more
efficient offsite and utilize the machines.

You know, you don't need to be sitting
there flipping paper in a conference room, -- you
could flip that somewhere else virtually. So, I
mean, I think it has a lot of promise if we can get
this right.

MEMBER DAKRI: I think from my side the
communication has been great during the exams and
up to the exit and then there is that black hole,
which is the exit, and then waiting for the actual
report.
So we had, not safety and soundness, but compliance several months back, and they left and everything was fine, and then it was three months and we're like, okay, anybody know what's going on with the report, where it is, and then it just showed up one day. There you go, it was done.

But, you know, for us in management we're like is something wrong, did they change something, are they looking at something, what happened in the meantime?

So any type of communication between the time they leave the field and the actual report comes out would be beneficial, I think, to us just to say we're still in process, or we're just behind, or whatever it might be.

MS. EBERLEY: And I think we try hard to do a good job. We turn around one- and two-rated examinations in less than 30 days is our average, and we believe that is important, as well, to get you your feedback as quickly as possible.

MEMBER DAKRI: Yes. I mean to be fair it was compliance, not safety and soundness, but
still it's --

(Laughter)

(Simultaneous speaking)

MR. PEARCE: Yes, I just wanted to mention that is actually one of the projects we are undergoing right now to take a look at what happens post onsite in the review timeframes.

For the most part, we turn our reports around pretty quickly, but we have identified some situations where it gets elongated and we really want to try to take a look at that.

So I am glad you provided that comment because it will help us in continuing our review of this issue.

MEMBER DAKRI: Thank you.

MEMBER TURNER: Could I just add one thing? You know, I agree with everything that everybody said.

I think as, you know, we all have an interest in the process as examined institutions and I think you guys do an awfully good job with that and I think it's a worthwhile process and a helpful
process.

But we also have an interest in what you are doing as members of the insurance fund. We all have this large, contingent liability that's our membership, you know, our interest in the membership fund and we talked about at breakfast that, you know, that there were some large institutions that failed or close to failed that if the resolution process hadn't worked so well the fund could have been another $150 billion or something underwater and, you know, that would have been all of us kicking in our fair share.

I mean, take 1 one percent of your assets, or whatever, and that's about what we would have had to pay. So anything, I mean you guys, I view the FDIC as our protection against having to do that.

So, you know, as you think about really risk focusing, I hope you'll think about, okay, where really is our risk, and I assume it's with the larger institutions, and I am sure this is a political issue, but being involved, it may not be.
You know, the more you can be involved on the front end before a problem develops, that something fails, the better off we are all going to be as members of the insurance fund.

MR. DAVIS: So I'll just -- I'm sorry to play timekeeper again --

MEMBER TURNER: Okay, sure.

MR. DAVIS: -- but we do just have a few minutes left for this panel, so there were a couple other topics.

MS. EBERLEY: So how about we switch over to Lisa and talk about BSA, and we'll try to pick up any other items in the supervision section next.

MS. ARQUETTE: Thank you, Doreen. I can go through this fairly quickly. In your materials, you do have four slides so I will just kind of zip through them, but I will be here at lunch if you have any follow-up questions.

So, just generally as far as the EGRPRA process goes, it doesn't cover the Bank Secrecy Act, -- the technical requirements like the reporting
and recordkeeping. It covers regulations that are issued by federal banking agencies like the FDIC.

However, I think at least 40 commenters, maybe every commenter had a little something to say about Bank Secrecy Act compliance.

So what we did was package up the comments and provide those comments not only to Treasury but also a bureau that oversees Bank Secrecy Act compliance, that's the Financial Crimes Enforcement Network.

But the one connection between the banking agencies and the Bank Secrecy Act is that we all were required to issue regulations to ensure that banks comply with the Bank Secrecy Act.

So for us that's 326.8 in the FDIC rules and regs, so we are connected to it because we require a BSA compliance program, but all of the discrete elements in reporting requirements you are going to find those in FinCEN's rules, with the exception of suspicious activity reporting.

So real quickly, issues that bankers
raised were what about increasing thresholds for currency transaction reports? Those have been in place since 1970. A long time, no adjustment for inflation, and people use cash a little bit differently.

What about adjusting the threshold for suspicious activity reports? There are a couple of different thresholds, whether you know the individual that is transacting in your institution, maybe you don't know the individual, it's a wire transfer, or maybe it's an insider-related matter, in which case currently there are no thresholds.

So the recommendation was, you know, make it easier, adjust the thresholds. Another consideration that was raised was increase the timeframe within which you come in and examine for BSA compliance.

Now we are required to examine an institution pursuant to Section 8 of the FDI Act every time we conduct a safety and soundness examination.

So the benefit of extending the cycle
for well-managed institutions, well-rated, well-managed institutions, is that you are going to see us less frequently in terms of examining for BSA compliance.

Those go hand-in-hand, provided the compliance program is running smoothly, and we are fairly certain that most banks have compliance programs that are running smoothly, because it is infrequent that we take enforcement actions, just to put that out there.

A couple of additional items that were raised were provide more clarity related to customer due diligence. FinCEN issued a rule in May of 2016. Since then they have issued two sets of frequently asked questions.

The responses have been included. Since then the rule has become effective in May of 2018. Since then the banking agencies, the FDIC included, we have issued our examination overview and procedures and made those public to the industry.

So since then, since the EGRPRA
comments, there has been an awful lot of guidance and procedures issued related to the implementation of those rules.

And, finally, the issue that was raised was cost. Bank Secrecy Act compliance is expensive, . It takes a lot of resources. What can you do about that, and can you make sure that there is consistency among your examiners?

So those are within our purview, and we can address those types of things, and we are working really hard to address them. That was one slide. Let me flip through the next three real quickly.

So what we did was gather up the comments and provide them to FinCEN and to Treasury. FinCEN is part of Treasury. They were very quick to respond.

We do work with them regularly and they said that they were considering thresholds, they met with law enforcement, and these are issues that are addressed at every Bank Secrecy Act advisory group meeting.
That is a public-private partnership between government agencies, banks, other financial institutions that are covered by the BSA like securities brokers, dealers, precious metals, precious gem dealers, money service businesses.

Anyhow, there is a semi-annual meeting where a lot of these issues are discussed and there are many subgroups. We have lots of subgroups within the beltway, but they have been fairly effective in dealing with issues like thresholds.

So FinCEN committed to making sure that these issues were raised to the BSAAG and these issues are discussed during FFIEC Bank Secrecy Act Anti-Money Laundering Working Group meetings. One is being held right now as we speak. The FDIC chairs that committee.

So there are many venues where we discuss these issues, but we always discuss them with information with feedback from law enforcement so that there aren't steps that are taken that would undermine the benefit of this information.

So FinCEN was very responsive and
continues to be responsive. Now, quickly, what can we do in terms of supervision? Examination frequency for the most part has been addressed for well-managed, well-rated institutions.

Customer due diligence and beneficial ownership information, -- our procedures have been issued. We plan to host a call with the other banking agencies open to the industry to not only review the procedures and overviews but also to take questions very specific to this issue. We plan to do that during the third quarter of this year.

And, finally, in terms of cost and burden we are very cognizant that the cost has increased. The Bank Secrecy Act has been in place for nearly 50 years and resources dedicated to this space have increased.

But the value of the information has also increased to law enforcement, so really there is an obligation to make sure that that information gets out there, that banks are aware of how very important your contributions are, the reporting that you do.
But, separately, and as a segue from what Rae-Ann was talking about for risk focusing, we really are keenly focused on making sure that we have the right resources at your institutions at the right time based on the complexity of your institution.

Not every bank has the same risk profile, the same products, services, customers, and entities. You don’t all operate in the same geographies, and we are aware of that.

So we are working pretty hard to make sure that we are addressing that, and that, if possible, we can address procedures that might be tailored differently to lower-risk institutions.

So we are working with the other banking agencies, with Treasury, and with the Financial Crimes Enforcement Network. All right, it's 11:15.

CHAIRMAN McWILLIAMS: Good job, Lisa, keeping us on schedule.

MR. DAVIS: Yes, I mean I think since we have some of the same participants in the next panel
if there is a question or two I think we could certainly take time for that.

MEMBER SCULLY: We're going to talk in more detail about beneficial ownership?

MS. ARQUETTE: We are. We are.

MEMBER SCULLY: All right.

MS. ARQUETTE: I would point out that that is FinCEN's rule, but I am happy to talk about it, and I will.

MR. DAVIS: Okay. So if I could ask Bob to come back up and join us for the --

MS. EBERLEY: I'm just going to stay if that's okay.

MR. DAVIS: Okay. We are going to do an update on several supervision issues with this panel and we have, again, the same panel, adding Bob as well, and Rae-Ann is going to talk about guidance issued by the FDIC and other federal financial institution regulators about supervisory practices to be followed when assessing banks impacted by major disasters.

Bob is going to talk about the
accounting and reporting implications of the new tax law. Bob is also going to review an example relating to implementation of the current expected credit losses methodology.

And, finally, Lisa is going to provide an update on customer due diligence and beneficial ownership requirements.

MS. MILLER: Okay. All right, so real, real, fast just to close out the last panel I was going to talk a little bit about, and be very quick about we also committed to doing a review, interagency review, of our guidance documents, and so we are embarking on that with the other agencies starting there, you know, things that are short of regulations but are supervisory guidance documents. So we have pretty much just started that.

And then I just want to touch on, we talked about it a little bit this morning, but also as a follow-up on EGRPRA, we very recently raised one of the thresholds in our appraisal regulations.

And just to refresh, you know, Title
XI of FIRREA required the agencies and NCUA to adopt appraisal regulations, and that law came out in 1989.

We issued regulations first in 1990, 1992, and then did a big overhaul in 1994, but haven't looked at them since. The law allows us to set exemptions in our regulations, and those exemptions apply to institutions or to transactions where if the exemption applies you don't need to have a licensed or certified appraiser perform an appraisal on those transactions.

So we got a lot of comments in EGRPRA. Y, you haven't looked at those thresholds since 1994, you know, it's 24 years on now, so we did look at those.

We put out a proposal in 2017 on raising the threshold for commercial real estate. We actually defined what we meant by commercial real estate and proposed a threshold raise of $400,000, from $250,000 to $400,000.

So the comment period closed in September 2017. We got about 200 comments, and you
can imagine where they were divided between bankers and appraisers.

But, basically, the final rule creates a new definition of and separate category for the purposes of the rule for commercial real estate transactions.

It raises the threshold for requiring an appraisal on those from $250,000 to $500,000. That nearly doubles the percentage of the number of transactions that would be exempted.

So it goes up from about 16 to about 32 percent of the number of transactions that would be exempted, but it only affects a small amount of the dollar amount.

So only about a 50 basis points lift was achieved with that. So 1.3 percent of the dollar volume of transactions would be affected. So these kinds of numbers enabled us to say, you know, raising the threshold to $500,000 doesn't really create a huge safety and soundness issue because really from a dollar perspective not that much has changed.
From a burden perspective, some of those transactions that Chris was describing, it has a big impact from going from $250,000 to $500,000, especially for smaller institutions.

And just a reminder that even for those exempted transactions, they would still be subject to having an evaluation done, but the evaluation doesn't need to be by a licensed or certified appraiser.

So I did speed talking on appraisals. Does anybody have any further comments?

(No audible response)

MS. MILLER: No. Should I move on to --

Okay, so I will move on to a piece of, we call it examiner guidance, but just sort of instructions for examiners that we issued at the end of last year.

So it's the FDIC, the Fed, the OCC, and the NCUA, and we were consulting with the CSBS, Conference of State Banking Supervisors. We issued examiner instructions to talk about the supervisory practices that would be followed in assessing financial condition of insured
institutions affected by a disaster.

And the disaster would be something that resulted in an order from the President that declared the area a major disaster, and there is different declarations, and a significant declaration is declaring a major disaster with individual assistance, and that's typically when these instructions kick in.

So, you know, we talk about -- we recognize that extensive damage, and you remember last year we had a terrible hurricane season, we had the fires in California, we understand that it affects the business activities, it affects the borrower's activities, and could do so for an extended period of time.

So we talk about in the instructions that the examiners are going to work with institutions affected to determine their needs, reschedule any examinations as necessary, consider extensions of filings for Call Reports, and address capital declines due to temporary deposit growth, -- sometimes you get a surge of deposits in these
situations.

And we talk about in the instructions supervisory practices for these types of institutions, and they could be located in a disaster area or have a lot of loans or investments that are in the disaster area, and we basically tell examiners you need to consider how management at the affected institution is dealing with the situation.

How have they conducted an initial assessment? How are they dealing with information as it becomes available? How are they working with their borrowers as the recovery efforts proceed?

We talk about, you know, examiners need to continue to assign component and composite ratings in accordance with the CAMELS rating system, but that they need to also consider the extent to which weaknesses are caused by external factors and not necessarily the management of the institution.

So when we are talking about CAMELS you could have a financial condition issue but management is doing everything they can to work it
out, and we would consider that in the supervisory response, you know, in enforcement actions and all those kinds of decisions.

   So that's a good description of the instructions. Any questions?

   (No audible response)

   MS. EBERLEY: Can we move on to Bob?

   MR. STORCH: Okay, thank you. Good morning again. The first thing I was asked to talk about was guidance the agencies issued on accounting and reporting implications, -- the new tax law.

   I'm sure it's not a surprise to everyone that there was a new tax law. Timing perhaps wasn't that helpful because it was enacted nine days before year-end. And under generally accepted accounting principles which by law, the principles governing the Call Report have to be uniform and consistent with that.

   Whenever there's a change in tax laws and rates, the accounting standards indicate that the impact of those changes have to be reflected in
the period that the law's enacted, which is when the
President signs the law.

So nine days before year-end, there's a
change in the tax law. So, so lots of institutions
were scrambling to determine what the consequences
would be for their year-end reporting purposes,
whether it was Call Reports or GAAP financial
statements.

One of the key elements of the change,
particularly for community institutions, assuming
you're not sub-chapterSubchapter S, you've got a
little bit of a leeway in that case.

But if you're Subchaptersub-chapter C
and pay corporate income taxes, the deferred tax
assets and liabilities on your balance sheet had to
be re-measured based on what the tax rates would be
when the underlying temporary differences or net
operating loss carry forwards would actually flow
through and show up in your tax returns in future
years.

So, basically, moving from a general 35
percent federal tax rate to a 21 percent tax rate,
which has consequences if you, like most
institutions, had net deferred tax assets. You're
reducing those assets because the benefit of the
temporary differences in future years will only be
realized at 21 percent instead of 35 percent.

You reduce an asset, the offsetting
entry is to income tax expense, which lowers your
net income for the period, has an effect on
regulatory capital, and so forth.

Presumably the lower tax rates would
benefit you going forward and help offset the
negative effect at year end, reflecting in most
institutions' cases that reduction in deferred tax
assets and an increase in income tax expense on a
reduction, therefore, in retained earnings and
common equity tier one capital.

So that was one of the elements that the
agencies wanted to ensure institutions were aware
of. And their issuance on January 18th, and it came
out from the FDIC in a financial institution letter
to our institutions.

The other agencies had their own cover
documents but there was an interagency statement. And since it touched on accounting, the agencies’ typical practice is to share drafts of these types of accounting guidance documents with the FASB and SEC staffs to make sure that we're not stepping outside the bounds of what's acceptable under GAAP since, again, we're supposed to be reporting requirements consistent with GAAP.

So the expectation was at least for sort of the fairly simple process of re-measuring deferred tax assets and liabilities, that would be reflected in the year-end 2017 Call Reports.

But one of the unusual consequences of having to do that, if you have available-for-sale debt securities, and again you're paying federal corporate income taxes, the amount that you reflect in your equity capital section of the balance sheet for the unrealized gains and losses is net of tax effect.

It had been measured originally when those gains and losses occurred, presumably at a 35 percent rate, but the tax rates were reduced to 21
percent.

And the way the accounting standards work, the change in the measurement of deferred tax assets and liabilities goes to the income statement, even though the tax effect for the unrealized gains and losses on available-for-sale debt securities didn't go through the income statement, it went through what's called other comprehensive income, an overall statement of comprehensive income but separate from net income.

So what you ended up with was a disparity between what the deferred tax assets or liabilities were associated with the deferred, with the unrealized gains and losses on available-for-sale debt securities and any other types of transactions that affect other comprehensive income and the AOCI accounting capital.

But the available-for-sale securities is the most common source for community institutions. So if you had had say $100,000 unrealized gain or loss and the tax effect would have been 35 percent, you adjusted the deferred tax
asset from 35,000, or the deferred tax liability from 35,000 down to 21,000, but the net unrealized gains and capital stayed at the net of 100,000 reduced by 35,000.

And that's the accounting terminology is that's a stranded tax effect. There's a disconnect between the balance sheet deferred tax assets and liabilities and what's in AOCI. So the FASB was made aware of this disparity and particularly for banking organizations and regulatory capital, consequences that some of this may have.

And they issued a standard ultimately in February, but they agreed to propose it in January. So our guidance essentially allowed institutions to early adopt the standard for year-end 2017 reporting purposes if they chose to, it wasn't a requirement, to eliminate the disparity caused by these stranded tax effects. So that's addressed and is an example in the interagency statement.

And then the final element we talk about, it ties back to the regulatory capital rules.
I'm sure you're aware there's limits on certain categories of deferred tax assets or net deferred tax assets, any that are resulting from net operating loss carry forwards or fully deducted those that are dependent on, or that could be realized through carry-backs are not subject to limit.

Those that are subject to future taxable income for realization, if they exceed certain thresholds, are deducted, those excess amounts are deducted from common equity tier one capital.

One of the consequences of the new law is it eliminates, for 2018 and beyond tax years, carry-back potential. So essentially, all deferred tax assets now become dependent on future taxable income. And even though the tax rates are lower, the entirety of those deferred tax assets net of liabilities under the capital rule are subject to these limitations.

So that's one element of the capital rules. There is an effort underway through rulemaking, and unfortunately Ryan's not with us
anymore, he could answer questions on it perhaps, but to do some simplifications to the capital rules and deferred tax assets was one area that was addressed in the proposal issued last year.

There's a minor silver lining, if you will. To the extent your bank actually pays current taxes in during a particular year and if you assume that all your deferred tax, your temporary difference is fully reversed and you have a tax loss hypothetically, you can offset it against and recover current taxes paid.

To that extent, those would be viewed for regulatory capital purposes as available to be recovered through carry-backs. So some small portion in some banks of their deferred tax assets may not be subject to these potential threshold deductions.

So those are some of the key points from the statement that was issued in January. I can stop there and see if you have any follow-up questions on that particular topic. Taxes is never anyone's focus on these. I know as examiners,
everyone wanted to avoid having to do the tax part of the income statements, or review it.

So let me turn to the second topic I was asked to talk about. In February, the banking agencies, well the Fed and the FDIC along with the Conference of State Bank Supervisors, and we had participation as well from the SEC and the Financial Accounting Standards Board, conducted a webinar that focused on trying to assist community institutions and get a start on understanding some of the more simple loss rate methods that could be used at a community institution as a starting point for estimating historical loss experienced under the new current expected credit losses methodology.

So that was at the end of February.

There's an FDIC Financial Institution Letter that was issued in early February. It includes a link to a recording of this webinar. There's a transcript, there's some presentation slides. I believe you have the slides in your materials.

So it's available to listen to as many times as you would like your staff to listen to it,
or not at all, at your pleasure.

One of the key points, I know I've talked about this before, is the agencies and the guidance we've issued so far, there was a joint statement shortly after the statement was issued by the FASB in 2016 and we've issued two sets so far of frequently asked questions the most recent of which was last September.

We've tried to emphasize that, particularly for community institutions, there's no requirement to go out and acquire costly and complex models.

We think most community institutions can use simpler approaches that build on approaches you're using today, but there would still be the need to change inputs because we're moving from the incurred loss methodology that's not very forward looking at all to the CECL methodology, the Current Expected Credit Losses methodology, that does take forecast the future economic conditions and other consideration of other future events to come up with an estimate of expected credit losses, not incurred
credit losses.

By the same token, we know a lot of institutions are being approached by consultants and third-party service providers. There's no requirement the agencies are imposing that those types of services be used. That's a business decision for the individual institution, and I think I've tried to emphasize that at past meetings.

The standard itself, very principles-based. It provides a lot of flexibility. Methods that are used today can be used going forward, and I say that with a little trepidation because some people have interpreted that to mean they don't need to do anything at all.

The approaches in your model, your methods, can be used, but at least a couple of key inputs would need to be changed going from the typical annualized loss rate to an estimate of historical lifetime loss experience and then building in the economic forecasts, because today you can really only consider past events and current conditions. Now we layer on top of that forecasts
that would affect the collectability of loans in future periods.

So that takes me to the webinar we had at the end of February. There were three methods that were described and examples provided there. And again, you have the slides.

One was called the snapshot or open pool method, there's a remaining life method, and then there's one that FASB also has an example of in their standard, the vintage method. But I thought I would just spend a few minutes going over some high points of the snapshot or open pool method.

That, if you're looking at your materials, and I'm not trying to be a teacher telling you you have to, but it starts on Slide 14. And when you go to Slide 15, what we're really talking about with this snapshot method is that we're looking at your loan portfolio or segment, particular segment that you're using.

And you can use the same sort of segments, if it makes sense, that you use today for the incurred loss methodology for pools of loans for
pools of loans going forward. You can refine them or adjust them as you see fit, but if they make sense today under incurred, again our guidance indicates that they can be used under the CECL methodology.

So we're taking, trying to develop an estimate of historical lifetime loss experience and we take a snapshot of all the loans in a particular segment of the loan portfolio as of a specific date and we just, to jump ahead quickly, Slide 18 which kinds of summarizes the example.

The bank, at the end of 2015, for a group of loans that are basically five-year type loans, and one way to pool loans is saying maturity but again that's not a requirement.

There's a lot of flexibility for how loans are pooled and segmented, and that would be a factor from a qualitative standpoint when you look at that particular pool and how you come up with your overall CECL estimate.

But again, the focus of this webinar was on the starting point of historical loss calculation. So we take a snapshot of all the loans
in that segment as of a particular date and look at what happens to them until the last loan in that segment or pool actually is paid off or charged off and look at each year, what were the actual charge offs on those loans that existed as of that snapshot date even though the overall portfolio is changing over time.

So we're trying to estimate the total charge-offs associated with that particular portfolio that existed at a point in time, we divide that by that starting point number, the portfolio balance or segment balance at that starting point, and that would give us, because we're accumulating the several years' losses, in this example it's on Slide 18, it's five years' worth of charge-offs on that pool that existed at the end of 2015.

So by the end of 2020, you're $88,000 in accumulated losses compared to the amortized cost starting point of a little less than $10 million. So the loss rate lifetime was a little less than one percent.

The webinar didn't get into the issue of
how you adjust for qualitative factors. I know we had a number of requests to have follow-up webinars or additional guidance on that. But this webinar didn't do that.

So just like with the incurred loss methodology, you've got a loss rate starting point. The new method, you look at historical lifetime as opposed to annualized and we adjust it to the extent necessary for qualitative factors.

What do we see going forward that will cause the losses that existed in that historical lifetime loss period to be different because of different economic forecasts, and so forth? Or you try to come up with the historical loss period that perhaps best represents what you think will happen in the future, and there the qualitative adjustments may not need to be as significant. But again, qualitative adjustments, hopefully that will be a topic for another webinar that the agencies can present.

So just like with incurred losses, once you've got your adjusted loss rate, here's an
adjusted lifetime loss rate, we apply that to the
then existing pool balance in our balance sheet data
to come up with our estimate.

And I emphasize that it's simply an
accounting estimate. It's not, you know, a hard
and fast forecast. This is actually the amount of
charge-offs we're going to have. I think no one
will ever get the exact number of charge-offs
because that's why it's an estimate, for this
particular segment.

So that at a very high and fast level was
the idea behind this snapshot or open pool method.
We have talked to a number of accounting firms that
work with community institutions, and they've
indicated that they view this as an acceptable
approach, assuming it's applied properly and
supported and documented.

But it is an acceptable approach that
can be used, along with the other two methods that
were described in the slides that you have.

So that's what I wanted to cover on that.
And I will mention that we are having another
webinar. And, in fact, this one the OCC will bejoining the Fed and the FDIC and the states, the FASB
and the SEC will again be participating.

And we've gotten, as you can imagine, and you probably have questions yourself, we've
gotten a number of questions that we didn't get to on the February webinar. The OCC's had some
webinars and they have gotten questions, and we've gotten questions from our email boxes, and so forth.
We had questions raised by examiners.

So we're going to devote an hour and a half or so on July 30th to go through a number of questions that we've received over time about various aspects of CECL. Bankers can submit additional questions in advance, and even during the webinar.

We'll just see if we get overwhelmed again with questions and can't cover them all. But those topics are grist for the next set of frequently asked questions that are already being worked on to supplement what's already out there.

So with that, hopefully, I didn't drown
you with too much details. But we can turn it back to you for discussion or questions.

MEMBER HANRAHAN: I'll make a comment if I may.

MR. STORCH: Sure.

MEMBER HANRAHAN: Actually, two comments. First off, thank you for reiterating that you don't necessarily have to use a vendor for this stuff. I've got plenty of vendors trying to scare me and trick me into buying things. So that comment is meaningful.

Fortunately, I've got a credit department manager who's a cracker jack, and he tells me that your February webinar, pardon me, -- “Ask the Regulator” webinar, was really good and he's now running vintage analyses.

And we're not there yet, but I have a sense that we're going to get there by 2020. So thank you for conducting those.

MR. STORCH: Thank you for the comments, and from what I understand, the webinar was very well attended. There were about 8,000
lines in use. So there's only 5,000 some banks, so either there were multiple bankers or there's a lot of interest outside the banking industry itself.

(Off microphone comments.)

MR. STORCH: It's interesting, though. I know in talking to one community banker who's been approached as you have by different vendors, he's inviting them to come in and hear what they have to say to see what nuggets he can take from those conversations and build into their own internal methods that they're developing and trying to avoid actually paying the cost of whatever those types of service providers or vendors or consultants are charging.

So there may be a benefit to hearing what they have to say, even if you're skeptical about even going in that direction.

MEMBER DAKRI: If I may, I think a year ago we were talking about CECL here and the expectation from the regulators were that we would see an increase in allowances and whatnot.

Is that still the case right now? We've
gone through our process, just as you have, and I'm not seeing much of a difference overall. We're doing a vintage analysis and the vintage gives me almost a big zero in which I have to then rely on my qualitative factors to get to a number that's meaningful at all.

So I personally am not going to see much of a change, I don't believe, but I'm wondering what the thought process is now from the regulatory side as far as, you know, a year later now, what do we think is going to happen?

MR. STORCH: I can start and anyone wants to add to it they can. I mean, from what we're hearing from bankers, it's a similar sort of reaction. The economy seems to be doing pretty well right now.

A lot of people are calling it benign so that some of the concerns that maybe existed as the standard was being developed in 2012 and 2013 are no longer present.

I mean, the agencies have been trying to avoid any suggestion that there's benchmarks or
standardized amounts of increases that we expect to see because it's going to be very institution specific, it's going to depend on the economic forecasts in 2020 or 2021, whenever it is that the effective date applies to your organization.

It depends on your portfolio mix. As we've learned more about it ourselves, the shorter the lives of the loans, the expected lifetime losses tend to be less than say with longer-lived loans just because there's more time that a loan could encounter some difficulties.

So I think there's only been one bank that I've heard that in their SEC filings has suggested what the level of increase would be and that was about ten percent. Whether that pans out to be what happens in fact kind of depends on what will happen in the future.

The international accounting standard on expected credit losses, it's not the same as what the FASB adopted. But the European banks and the Canadian banks and so forth had to adopt it either late 2017 or beginning of 2018, depending on their
fiscal years.

And they, in many cases, are only seeing five to fifteen percent increase in their provision levels, although they didn't quite, maybe Canada did, but from what I've heard, but the Europeans in particular, even though they had an incurred loss model, they didn't apply it anywhere, with anywhere as much rigor as I think we have seen banks in the US U.S. apply it.

So at this point, we're hoping it's not a significant shock. But the agencies did propose, and I think the formal proposal was published in May, that there is, would be a transition option for regulatory capital purposes.

So to the extent that there is a significant decrease from the initial adoption in your common equity tier one capital that you could spread for capital purposes, not for accounting purposes, that reduction over three years so that some of the adverse effects on the regulatory capital ratios may not be as dramatic as they otherwise would be.
So there's that that's out there. It hasn't been finalized yet. I'm not sure what the timing is but, hopefully, that's something that some banks will consider using as well to mitigate whatever effect, even if it's small, on capital because the proposal is to spread it over three years.

Maybe the number is small at initial adoption, but if there's deterioration in the forecast, say a year and a half into the three years, it may be beneficial to have a small add back at that point to your regulatory capital to offset whatever increase you might need to make in the allowance levels because of worsening economic forecasts during that three-year period.

At least that's my editorial comment about the benefit of that potential transition rule.

MEMBER DONNELLY: Bob, the level of support, and you said support documentation, I know that's going to be relative to each institution what they have. But doesn't the core provider, the data
that you can keep over time and how you match it up to get the vintage model, because I was one that went and got a vendor to get it because I can't manage the data from a core provider.

So my expectation was the field guys came in, the examiners came in, they would want to see my supporting documentation. What do I have to do? Do you have an expectation set yet? What are the field guys going to be looking for when this kicks in?

We got a couple years to go on this, but what are they going to be looking at for supporting documentation? I mean, I can pull out 500 spreadsheets on Excel and say here "Here," but I don't think that's what they're going to be wanting.

They're going to be wanting to see more clarity, more not simplistic, more efficient reporting. Do you have an idea yet of what you're going to be expecting to see?

MR. STORCH: That's one area I think that we're going to need to provide clear guidance to our examiners so they don't sort of overstep
their expectations because they should be tailored to the size and complexity of the institution and its portfolio.

I mean, that's our general rule throughout all policies. We have existing policy guidance for the incurred loss model about documentation and so forth, and I would think those types of principles that apply today would continue to apply under the CECL methodology.

So you're going to have the raw data that feeds into some more aggregated data, and then it will ultimately be summarized up as it goes through your management to the board of directors for their review.

So I think that summarization of the data and at least understanding what the source, underlying source data is, I don't, I wouldn't expect examiners to spend time, you know, tracing all the years' worth of individual loan data.

They're going to look to the process that they're following or your vendor's following for the documentation and support. And we can
clearly get some good guidance, and I think that's one of the questions that's on the table for that July 30th webinar is some more guidance about documentation.

MEMBER DONNELLY: I think your comment about you don't expect the examiner to, I mean, that's a really important piece to get out because I've seen them track the data, at least the way I interpret it and I've sat through more CECL seminars than anything I've ever done in 36 years of banking.

So you know, from my perspective, the net effect could, doesn't mean it will, it could be significant. And we better be in front of that. So I think your comment is what is my concern is what will the field examiners be looking for in documentation, small shop versus somebody who can throw a couple of accounting people at it is different.

MR. STORCH: Yes, very different.

MEMBER HANRAHAN: Chris, my hunch is our auditors are going to be giving us a harder time about methodology than the regulators. So I'm glad
you got FASB involved in these calls.

MEMBER TURNER: We've also used a consultant, Bob. And one of the things they've told us is that as you collect this loss data on pools or cohorts, they really want to see the loss data go back across credit cycles. Do you agree with that?

I mean, they don't want, like, if you're collecting loss data on a particular category of loans, they're saying we don't want you to just collect it during a very benign period.

We want you to collect it across the credit cycle so we can really get a full picture of how that cohort's going to perform. Is that how you see it as well?

MR. STORCH: I think if you're just talking theory and there's no cost for information, that would be the answer.

MEMBER TURNER: Right.

MR. STORCH: But let's be realistic. You're only going to have data, I mean, if you start collecting data now, I don't think people can hear
me. If you start collecting data now, or you started maybe a couple years ago when we put our first joint statement out, you from some loan portfolios you may have the full lifetime. For others you may not.

And what we've indicated is you may need to use proxy data to fill in gaps. There may need to be qualitative adjustments to compensate for the lack of complete data. And we're all learning about this as we go forward.

Say ten years from now you'll have a pretty good set of data. But to expect every community bank in particular to have loss data and all the other relevant data going back --

MEMBER TURNER: Fifteen years, yes.

MR. STORCH: -- over a whole credit cycle is not really realistic. There is an undue cost and burden provision within the standard itself, and in the set of frequently asked questions that were added last September, I think one of the first questions talked about data and is there an expectation that community banks would go back and
reconstruct data that no longer was readily available.

And the short answer was no “No, we're not.” So we’re trying to be realistic, and this is going to be an evolutionary process that the first estimate we want a good faith estimate as best you can do, and document how you got it.

And over time, everyone's going to learn and get better at it, just as it's happened with the incurred loss model which we've had for 40 years. Everybody's still making little tinkering improvements over time.

MEMBER TURNER: We're a public company. Is it your impression that the SEC is taking that kind of a moderate approach, or are they going to say hey “Hey, the rule's the rule,” and you're expected to, you know, they expect their reports to be in accordance with GAAP. And if it's hard on you, it's going to be hard on you.

MR. STORCH: That's probably a good question if you --

MEMBER TURNER: For them?
MR. STORCH: -- or your staff listen to the webinar at the end of July to specifically direct to the SEC.

MEMBER TURNER: Are they going to be on there?

MR. STORCH: They will be on there, yes.

MEMBER TURNER: Okay.

MR. STORCH: They have policy guidance that's comparable to the interagency policy standard on documentation and methodologies that dates back to 2001. I think it's called SAB-102 and it has very similar language and it sets out their expectations for governance and controls and documentation just like our 2001 policy statement does.

And they would expect similar documentation in support, but I would imagine they would have a realistic view of what's possible for a smaller community bank that's a public institution.

And you can also be talking to your auditors who may have had interactions with the SEC
in terms of expectations as well.

MS. EBERLEY: All right, thank you. Can we shift over to Lisa, picking back up with BSA?

MS. ARQUETTE: Okay. Thank you, Bob. Thank you, Doreen. The topic that I would like to cover is customer due diligence and beneficial ownership requirements. The rule was issued by the Financial Crimes Enforcement Network, the Administrator of the Bank Secrecy Act in May of 2016.

And there was a two-year period within which banks and securities brokers and dealers could establish systems, policies, procedures, et cetera to become compliant with customer due diligence, I'll call that CDD, and beneficial ownership requirements.

I would like to say up front, I think banks are really good at customer due diligence. You've always done customer due diligence. You know through underwriting, you know, what the expectations are associated with the repayment of loans. You know your customers certainly on the
asset side of the balance sheet.

Sometimes different standards have applied to the deposit side. So this really takes all of our expectations and codifies them in terms of customers on any side of the balance sheet.

So we have had written guidance in place since 2005, and that's the first time we issued the FFIEC, Federal Financial Institution Examination Council, Bank Secrecy Act Anti-Money Laundering Manual.

So we've had the guidance in place, but this really codifies it. That's the customer due diligence piece. The new requirement, however, is to collect beneficial ownership information for legal entity customers.

This has created a lot of feedback from the industry. And over this 24-month period, not only have we joined FinCEN in meeting with bankers, with trade groups, et cetera, just understanding what the concerns have been, but we reviewed frequently asked questions that they ultimately issued to deal with a lot of these questions.
So just like the last presentation, you do have a slide deck if you want to refer to it now or later, or whatever you would like to do with it. But I'm on slide two.

So as I mentioned, the rule codified customer due diligence expectations. And the FDIC, along with the other banking agencies, we issued the procedures, the overviews and the procedures May 11th of 2018.

So what our examiners will be doing in your institutions, you've got the roadmap. You understand the overview and you've got the procedures. So just in the spirit of full transparency, we do that and we make our manual public. These are two new chapters in the manual.

What does customer due diligence do? Well, it requires a bank to understand the nature and purpose of customer relationships for developing a customer risk profile. Makes perfect sense to me, and I'm sure to you, as well.

But it also requires conducting ongoing monitoring to identify and report suspicious
activities, which has been an obligation for a number of years, and it requires that banks update and maintain customer information on a risk basis.

So there is some subjectivity clearly in the rule. It's not like a capital threshold, there is some subjectivity. So understanding the nature and purpose of the relationship makes sense. Adjusting data that you collect based on risk also makes sense to me. So these are things that banks have been doing for a long time.

Moving on to our procedures, what should you expect examiners to be looking for? Well, they're going to look at the bank's risk profile. And where do we get that information? We get it from your risk assessment.

Banks have Bank Secrecy Act/Anti-Money Laundering risk assessments and have for a number of years. And for the most part, that is our roadmap to understand where the bank has identified higher risk products, services, customers, entities, and where they operate.

So the bank really provides the roadmap
for us essentially to start our transaction testing, to look at accounts or customer relationships that the bank has identified as higher risk.

For policies and procedures, we'll look to make sure that the bank has identified responsibilities of staff members, that the policies and procedures provides for documenting customer due diligence analysis, and addresses how customer information will be used, and if there's a problem in collecting information, how those deficiencies will be addressed. So it's really a comprehensive customer due diligence policy.

In terms of how the information will be used, generally customer information is used for a lot of purposes. But for suspicious activity monitoring, for identifying somebody that is on the Office of Foreign Assets Control Specially Designated Persons List, so those are -- and you know drug kingpins, individuals that have been identified by OFAC as creating some significant problems for the U.S.
So this information is helpful in identifying those individuals, as well. So that was the easy part. Now beneficial ownership information is a new requirement, and this is where we've received the most feedback.

This has been established to remove kind of the obfuscation, or to remove the ability of individuals to shield themselves behind a corporate identity. So if an institution has a legal customer, the expectation, now the requirement, is to collect beneficial ownership information.

Well, what does that mean? Definitely it means that they need to collect the name of somebody who influences control in the institution, something like an executive in most institutions that we supervise. So they need to collect that name.

Second, they're going to need to address the ownership prong. So the ownership prong is an individual that owns 25 percent or more of the equity interest in the legal entity.

If there is nobody that owns 25 percent
or more, they will have the individual who exercises control over the institution, and that's it. But they could have up to five beneficial owners.

Let's just say there are four individuals that each own 25 percent, and then there is somebody who exercises influence that is not one of those equity interest holders. So banks should be collecting that information as of May 11th, 2018, for newly-established relationships.

It is not retrospective. There is not an expectation or a requirement that you go back and fill in the information, unless there's some type of triggering event and you have reason to believe that you need the information, and you would need to collect that information. But this is a going forward regulation. So you don't --

MEMBER SCULLY: Except as I understand it, if you've got, for example, live credit information, and the question is would that include something like an overdraft line for a smaller company that that renewal triggers an event where you now have to gather it.
MS. ARQUETTE: So that's a great question, and that's the question that we've heard most frequently. What about loans that are account relationships, or CDs that are account relationships that automatically renew?

So an overdraft protection feature or a CD that automatically renews, just a very short-term CD, do you have to keep collecting that information? The first answer from FinCEN is yes, you do.

The second answer on May 16, of 2018, was that they granted acceptable relief for 90 days while they consider the issue because it has been raised frequently about these automatically renewing instruments. So they're considering it right now because it is a real practical issue that is faced by banks.

Now, if you have information and you believe that it's correct and nothing's changed, you don't have an obligation to go back and ask for the information again. You likely have the information going forward. So that's something
that is under consideration.

They've been pretty responsive to industry questions and issues that have been raised, and that's a good example of taking a step to deal with that.

MEMBER SCULLY: And does somebody answer the questions, or is it that they consider the questions and modify their responses. You don't need to --

(Laughter)

MS. ARQUETTE: Thank you. Well, they have issued two sets of FAQs, one shortly after the rule was issued, I believe it was in June of 2016 and then another set of FAQs in April of this year.

So I think they actually have responded to a lot of concerns that have been raised by understanding the mechanics behind a lot of relationships, responding to beneficial ownership questions, and just dealing with the true implementation issues that are being faced.

So you jumped ahead, but that's okay. So that's a good question to raise.
MEMBER MENON: With an existing relationship opening a new account, does that affect that? You know, if there is a renewal of it or just a new account?

MS. ARQUETTE: New accounts you should be --

MEMBER MENON: But an existing relationship.

MS. ARQUETTE: So here's another great question. What if something like this, you had a legal entity that opened multiple accounts, so going forward they open an account, you collect the beneficial ownership information, but they open several accounts for different business purposes. Do you have to keep collecting it?

No, unless you have reason to believe that you need the information, that there was a triggering event that the individual who controlled the entity has changed. You might get that information on the loan side or just by reading the newspaper.

But you might have reason to believe
that you need to ask for the information again. So if you have multiple accounts and you've already got the beneficial information for the first account that opened after May 11th, you don't have to keep going back and asking for it unless you have reason to believe that something has changed. Okay.

MEMBER TURNER: And so you don't have to see evidence, I mean, you just ask them who owns the company?

MS. ARQUETTE: Well, it is --

MEMBER TURNER: You don't have to see stock certificates?

MS. ARQUETTE: That's another really good question. It can be fairly simple. FinCEN provided a certification form when they issued the rule.

So the individual entering the institution and establishing the account, maybe it's a deposit account, maybe it's a loan, they enter the institution, represent the legal entity, whatever it is, ABC Company, a corporation, a limited liability company.
And they say I'm the CEO, I am the beneficial owner and there are no individuals that have 25 percent ownership interest, and they certify it. So you've got certification that you've collected. It really can be that simple.

Now if a bank wants to take additional steps and you have internal policies and procedures that would cause you to ask for more information, that's perfectly fine. That's an internal decision.

Do you have to go back and validate articles of incorporation, look for some kind of verification that individual A owns 25 percent? No, it's an attestation by the individual opening the account and a certification, signing a certification who the beneficial ownership is. Beneficial owner, excuse me.

MEMBER TOLOMER: When somebody creates an LLC, wouldn't it be more practical for them to provide that information rather than to come to the banks and expect us to get the information?

MS. ARQUETTE: You mean provide it to
the state where they established the LLC? There are --

MEMBER TOLOMER: It would be logical.

MS. ARQUETTE: There are countries that collect information on a centralized basis. We're not part of that group right now, and it makes sense for, you know, a lot of countries to have a centralized location. That has been raised several times. Right now the obligation is --

MEMBER TOLOMER: Banks.

MS. ARQUETTE: -- the bank's obligation, securities brokers, and dealers, also.

MEMBER SCULLY: For economic reasons I would suspect. They don't have to pay us to collect it.

MS. ARQUETTE: Thank you. Thank you. That was a rhetorical statement, thank you. Any other questions related to customer due diligence or beneficial ownership?

I did mention during the first session that we planned to have an industry call, webinar, to go over this topic in more detail. When we have
these calls, we are joined by FinCEN who addresses
the technical issues associated with the regulatory
requirements.

They deal with the beneficial ownership
issue. We generally will talk about the overview
and examination expectations. So I would
encourage you to look for the notice when we set that
up.

It promises to be probably a very
interesting meeting, especially since banks will
have had some experience in this area leading up to
the webinar.

MEMBER SCULLY: And what is the
expectation? And maybe you said this, but what is
the expectation that at some point you have to get
to a human being?

MS. ARQUETTE: Well, you --

MEMBER SCULLY: In certain
transactions, you know, there are trusts or other
LLCs or partnerships that hold the beneficial
ownership.

MS. ARQUETTE: Another good question.
So if you've got a sole proprietorship you already know who the owner is, right? If it's a trust, now that has been excluded from the definition of a beneficial ownership requirement. So FinCEN has laid out the exceptions.

And you're not going to find articles of incorporation, so an LLC, a corporation, if it was just an arrangement, an agreement between a group of people, you're not necessarily, you're not obligated to provide the beneficial ownership of this arrangement that is informal.

So they've, I think, done a fairly good job up to this point of identifying where there are some carve-outs.

MEMBER DONNELLY: Has there been any benefit analysis or cost analysis on cost-to-benefit? Has the FDIC done any of that? Is there anything in the background that says let's “Let's look at this?”

MEMBER SCULLY: In fairness, they're just responding to FinCEN.

MEMBER DONNELLY: I understand that.
MEMBER SCULLY: And you weren't here a couple of years ago. FinCEN gave a presentation and when they were specifically asked if based on all of these millions and billions of pieces of data that they had accumulated at our expense, whether or not they could provide some better statistical analysis of how to do something other than look over your shoulder blindfolded and throw a hatchet as opposed to a more finite dart, they were unable or unwilling to answer that question and literally pulled out the terrorist card in their answer.

MS. ARQUETTE: They did do a cost analysis that's part of the rulemaking process. I think they actually went through it twice. The second time was pretty rigorous. And again, it's only an estimate about how much it will cost versus the benefits. So I will pass along the comments from today.

CHAIRMAN MCWILLIAMS: Could you maybe send Chris the cost-benefit analysis that was done?

MS. ARQUETTE: I sure will.

CHAIRMAN MCWILLIAMS: Thank you.
MR. DAVIS: Well, I was just going to say we do have a few more minutes before we're scheduled to break for lunch since I had to cut off debate in the prior session.

I guess I would say if there's any questions over either session, we do have a few minutes if somebody would like to bring something up.

MEMBER DAKRI: If I could just make a comment on the disaster recovery. You know, I look at the guidance here and I understand that we have to have some type of guidance for the examiners.

But my comment would be if we could have, make sure the examiners give a little bit of leeway to the banks that are involved in these type of things. You know, we went through it in Houston with Harvey, and when these things happen, you just do whatever you have to do to get things done.

You know, paperwork might not be great, everything might not be ticked and tied and in the right spot, but you're trying to help the customer out, do whatever they can.
And so if there can be some leeway from the regulatory agencies to make sure that, hey, we're not going to criticize you for this. You know, we were fortunate. We had, a week after Harvey hit we had a safety and soundness exam. Six months after that we had a compliance exam.

So some of the questions that came up on the compliance in particular was your documentation is a little bit vague here for giving these people six months of no payments or whatever it was.

Okay, yes it was vague. I apologize. But the only thing that I could say was I asked FDIC and here's my response, here's the email. So you tell me what I was supposed to do. But you know, if there can be something from the examination standpoint to say, you know, give them a little break, make sure that we're not too critical.

And when I looked at this document here I noticed on management it said analyze management, how they reacted, what they did. Now my only point I want to make here is that okay, we had been through it, we've gone through it.
But 99 percent of the banks will never go through it. So how do you utilize that information for the bank that does go through it and criticize them when you have no opportunity to criticize the other 99 percent?.

MS. EBERLEY: So the point of that guidance is to not criticize. The point of that is to --

MEMBER DAKRI: Right, but it does say you should --

MS. EBERLEY: -- you know, understand --


MS. EBERLEY: Sure.

MEMBER DAKRI: And human nature is you're going to put those comments in the report about this should have been done better or that could have been done better.

And so while I understand it's not meant to be a criticism, it's you're looking at something that happened and giving commentary and criticism
if you will, constructive criticism about maybe you should change this, change that, change that.

Now you're holding a management team that's gone through it to a slightly different standard than the 99 percent of the other banks that are in the country that don't go through this process. So that's my only comment is I think there needs to be a little leeway that these things don't ever end up in a report anywhere.

It's more of a learning process not just for the banks but for the FDIC, for OCC, whoever the regulatory agency is that that takes place because I look at this and I can tell from my experience I'm like wow, this is going to get into a report and there will be some commentary about, you know, what did they do with staffing, what did they do with this, what did they do with that.

You know, all these type of items are listed here. I think it just would end up in a report or in some commentary of a report.

MS. EBERLEY: Yes, and very well. But again, hopefully from a positive perspective. You
know, this is what management did to respond, this
is how management took actions with the point being
that so let's just say you're in a marketplace where
you've had asset deterioration because your
borrowers have, you know, lost values and they
didn't have flood insurance.

And so you're experiencing asset
quality problems which are turning into earnings
problems which are maybe impacting your capital.
You know, management is giving borrowers leeway to
try to work with them as we've requested that you
do when we send out the guidance right after a
disaster and say please work with your customers.

Things usually end up better in a
situation like that when bankers are giving
borrowers some assistance, you know, deferrals of
payments, those sorts of things working with
borrowers as they respond to the emergency
situation.

Point well taken, and you know, we'll do
some follow-up and make sure. Every report of
examination is reviewed at a regional office by a
case manager who's trained to prepare, to conduct
that review.

So if the policy weren't being carried
out properly, we would expect that it would be
cought at that level. And we would ask that if you
experience any difficulties at all, you know, let
us know because that's certainly not the intent of
the guidance.

The guidance is intended to give
management that kind of deference for the kinds of
decisions you have to make in a critical situation
where your focus is on helping your customers, your
community respond to a disaster.

MEMBER DAKRI: I think the point I was
just trying to make is give the bank a little bit
of, you know, leeway saying not a problem because
while some people go through it unfortunately,
other people don't have a chance to and you look at
contingency plans and whatnot.

They're only as good as they're written
on a piece of paper until you have to use them. So
most people never have to use them.
MS. EBERLEY: Yes.


MEMBER WILLIAMS: There was a question earlier where I think it came up down here on FDIC insurance costs and what have you. And I don't know what the correlation or how it works between the examination group and whoever sets those rates.

But just an interesting kind of personal phenomenon on that. We went through the process, exam was first of the year. Rated well, we'll put it there. And you know, we set our budget.

And then after the exam we had a bump in FDIC costs which our rating had not changed and such. And the reason was some concentration. Okay, I understand credit concentration, but what we didn't have was the other side of the discussion to talk with anyone or have an opportunity to appeal that.

There may be and it may be something I'm unfamiliar with, but you know, what they didn't know we did is we put a mandatory minimum PCE capital number in there of eleven and a quarter percent.
We increased our risk based to 15 percent and the concentration in the ADC area we put an 80 percent of it was in vertical construction in residential that has zero standing inventory in the market right now. Pretty safe stuff.

So you know, we look at CAMELS rating being what it is and we assume a rate there, but there's one, a trigger, but we're not able to look at the other side of the trigger that where we put in some safety mechanisms to ensure that there wouldn't be any more risk to the FDIC fund.

How does that work or how do we interact with the FDIC on those kind of issues?

MS. EBERLEY: So you're talking about the deposit insurance pricing model?

MEMBER WILLIAMS: Yes, yes.

MS. EBERLEY: Which is handled by our Division of Insurance and Research. They're going to be talking later this afternoon about assessment credits. We don't have a lot of time. I don't know if Diane's in the room right now, if we'll be able to talk about that.
But if we can't talk about it today, it certainly is something --

MEMBER WILLIAMS: No, I'll find discussion or something.

MS. EBERLEY: Oh, and we can also put it on the agenda for next time to have a presentation about the small bank deposit insurance pricing model, how it works, what the nuances are.

So the CAMELS components are one factor. Financial ratios are another factor. And so all those things work together. But we could certainly have a conversation about that at a future meeting.

MEMBER WILLIAMS: Thank you.

MS. EBERLEY: And see what we can answer this afternoon.

CHAIRMAN McWILLIAMS: And maybe we can give him some information on the appeals process.

MS. EBERLEY: Absolutely. And so there is an assessment appeals process as well, like you appeal your safety and soundness examination findings.

MR. DAVIS: Great.
(Off microphone comments.)

MR. DAVIS: Okay, we're going to break until 1:30 for lunch, and we'll see everyone back here at that point.

(Whereupon, the above-entitled matter went off the record at 12:18 p.m. and resumed at 1:32 p.m.)

CHAIRMAN MCWILLIAMS: All right, I think we can get started for the afternoon session now that everybody is all fed and caffeinated.

MR. DAVIS: Okay. I don't have a gavel, so I'll just kind of --

CHAIRMAN MCWILLIAMS: You know what? I am bringing the gavel.

MR. DAVIS: So we thought we'd start this afternoon with providing the committee with a community bank research update. From the FDIC's Division of Insurance and Research, we have Diane Ellis, the director, Patrick Mitchell, the deputy director of Risk Analysis and Pricing and George French, acting deputy director for the Office of the Chief Economist and Regulatory Analysis Branch.
Diane is going to highlight the publication of Crisis and Response: An FDIC History 2008 to 2013. Then Pat is going to review the quarterly bank performance results for community banks. And finally George will discuss the broader financial trends for community banks. Diane?

MS. ELLIS: Thanks, Chad. Good afternoon everyone. I'm not going to take up too much time. But before I do turn it over to Pat and George, I would like to say a few words about the book that you have in front of you.

This study was published late last year and reflects the FDIC’s unique perspective and role in the financial and banking crisis and our response to their challenges. We wrote it with the intention of complementing the growing literature on historical accounts of this period. And it's intended to not only inform policy makers now, but hopefully it will be useful to those who may be confronted with similar challenges in the future.

We organized it into -- you'll see that we organized it into two parts. Part 1 documents
the origins of the financial crisis and the steps the FDIC took to respond to it. So it includes a chapter on our Temporary Liquidity Guarantee Program, which you might recall included a guarantee of newly issued debt. And then unlimited coverage of certain non-interest bearing transaction accounts. And it also describes our use of what we call our systemic risk authority to provide open-bank assistance to some of the largest institutions at the time.

Part 2 covers what we describe in the book as sort of the follow-on banking crisis, which was -- felt more like say the crisis of the 80s and early 90s. And it highlights the challenges the FDIC faced in carrying out our core mission of supervision, deposit insurance and failed bank resolution. And has a chapter each on those functions.

We felt like the time was right to prepare such a study, given that it's been, believe it or not, ten years since the onset of that financial crisis. And we felt like we still had
enough staff around here with firsthand knowledge of what went on. So before they all got away, it was important to document that.

And we also felt like preparing a study and releasing it to the public was a way for us to learn not only what we did well, but what we could have done better. So that's the point is to spark conversation about that. And we're happy to provide you all a copy with the study today. And hope that you find it useful. And if you do have time to read it, love to get your feedback on it.

So that's --

(Simultaneous speaking)

MS. ELLIS: Yes. All right. So with that, I will now turn it over to Pat. Pat?

MR. MITCHELL: Sure, thanks Diane. So good afternoon. I have the opportunity today to talk to you about the first quarter results. If you will, there's actually a slide deck in here that I'll use because I think pictures work very well in depicting results. It's under, I believe, in the community bank research section. And it's a slide
that hopefully says community bank -- slide that says community bank performance first quarter 2018.

So I'm going to take probably about ten minutes to go over these slides. And as you may recall in 2014, the FDIC added a section to its quarterly banking profile that focused specifically on community banks. And so as reported here and as shown in the slide deck, we've defined community banks using the FDIC definition. Which is focused on activities, location, branches, as opposed to just using size.

So with that, I'll turn to Slide 2 please. So this shows higher quarterly earnings. First quarter was a very positive quarter for community banks with continued -- showing continued demonstrated progress and continued improvement.

The net income was up almost 18 percent over a year ago. The primary drivers are really net interest income, which was up almost ten percent, non-interest income up mildly 3three percent. And then income taxes was a large contributor this quarter, as they declined by 22 percent given the
new tax bill and the lower corporate tax rate.

So that was a contributor that we're going to have some comparability issues as we go quarter over quarter over the next year, up until first quarter '19 when we're more normalized. And that noise, if you will, will be removed.

On the expense side, non-interest expense was up almost 7 seven percent. And provisions were up almost 24 percent, but I'd highlight, that's off a very low base. So the provisions have been relatively low. So even though it's a large percentage increase, we didn't view that as anything abnormal or any type of -- any real takeaway from that.

The improvement was also broad-based across the industry. So almost seven out of ten community banks reported higher earnings than a year ago. So it wasn't just 50 percent doing well. It was a broad-based improvement.

And then if you look at the chart at the bottom right, NIM. The chart shows that NIM improved almost ten basis points up to 3.64 percent.
And it remained materially higher than the industry NIM at 3.32 percent. So community banks continued to outperform the industry in terms of net interest margin.

So on to Slide 3. Slide 3 focuses on pre-tax ROA. And here the industry -- the community bank remained relatively flat at 1.33 percent. Pre-tax ROA, it remains well below the industry average of 1.62 percent. I would note that, that gap has remained pretty steady post-crisis. And it's largely due to the amount of non-interest income generated by some of the larger institutions that generates that difference.

Looking at the chart in the lower right, revenue as a percentage of assets is at 4.22 percent, up 4 four basis points from a year ago. What I find interesting on this chart is that really, it's been pretty range-bound. Some ups and downs quarter to quarter, but no real -- I'd say there's no real material trend in that number. It appears to be fairly stable. This increase over the last quarter was driven by an increase in net
interest income of 10 basis points.

    So Slide 4. This is more of a good story. Asset quality remains strong. The non-current loan rate is down to 0.85 percent for community banks. And this is the lowest level since 2007. Using a little gallows humor, we know what happened post 2007. We hope that's not going to repeat itself. But it is showing very strong credit quality and loan performance.

    I would also note that across all loan categories --, or most loan categories, they saw declines in their non-current loan rates. With two exceptions and these are areas we're certainly focused on. Farmland and agricultural production loans. For those of you that are active in the area, certainly ag loans are an area of focus. And an area where we know that there's some level of stress. And you know, prices have continued -- recently have seen some volatility. So we're going to continue to watch that performance, as I know you all will.

Looking at the chart in the bottom
right. Looking at net charge-offs, the net charge-off rate is up over the last year, but not significantly. It's up from 0.11 percent to 0.13. So it's really a small tick up and that's primarily been driven by C&I loans. You'll see the line there showing the credit card charge-off increase, but that's really not a significant part of the community banking portfolio.

On to Page 5, Slide 5.

MEMBER KELLY: Excuse me.

MR. MITCHELL: Sure.

MEMBER KELLY: Is there a certain portion of C&I that seems to be bumping or not or when the charge-off from the C&I is up? I mean is there a certain --

MR. MITCHELL: And again, it's from a low level. We're not really seeing -- And again, we're a little bit constrained by data, so we're not really seeing any one area that we would point to. We do know that there's some recurring -- it can still be related to some of ag downturn and also some of the energy. So there's a little bit of residual,
though we haven't seen a huge tick up there, either.
So it's notable in that it's the only one -- only
major loan category that really ticked up. Not
notable necessarily in its size.

MEMBER WILLIAMS: Are there any
geographical differences or significant
differences in these charts that are national?

MR. MITCHELL: Again, nothing that
really jumps out. But of course there's some in the
Kansas City region.

MEMBER WILLIAMS: Okay.

MR. MITCHELL: Some in the Dallas
region that are showing up because of the ag. And
still some again marginal residual from the energy
downturn.

So on Slide 4. Oh, sorry. On Slide 5,
we moved on. So loan growth. Again, this has been
a very strong story for the community bank. Loan
growth remains strong, 7.4 percent. It's much
greater than the industry. The industry is at 4.9
percent annual growth. And that's also for some
period of time, the community banks have exceeded
the industry. And also have well exceeded GDP growth. So this is part of the story that's been going on for some period of time. Really it seems that loan growth is strong. And community banks are having the opportunity to make loans. It's also been broad based across all major loan categories. The highest growth has been driven by what we call non-farm, non-residential. But as well all know, essentially CRE, so commercial real estate. So that's been the primary driver of the -- or a significant driver of the largest grower across the major loan categories. Looking at the chart on the right, and George is going to touch on this a little more in depth, but the trend of loans to assets at community banks have been very -- it's been a sustained trend since hitting the low of 62 percent in 2012, up to today's loan-to-asset ratio of a little over 70 percent. It's been sustained and it appears to be strong. The industry's at 56 percent and you'll see there that -- you know, that's been a little
flatter and it's been less pronounced. There's been a small tick up but nothing that I would -- nothing that I would mark. So there the community banks have definitely been growing their loans as a percentage of assets relative to the industry. Feeds into the loan story.

So now on page -- last slide. So the last slide is a bit of a note of caution. The interest rate risk has increased significantly for community banks since 2010. Focusing on the liability side -- so the upper right chart first. The chart shows what I want to focus on are the time deposits and the maturity schedule. And those are the solid and dashed black lines. So those represent time deposits by maturity. But even looking at them in total -- if you look at them in total, total time deposits have declined from 37 percent of total assets to 22 percent of assets.

I'm telling you a story I think you all know, and you've lived it. So this isn't necessarily news, but it does show up on the charts. The interest rate environment just hasn't been
1 conducive to really attracting time deposits. And
2 I'm sure you -- not a whole lot of people have
3 interest in locking up their deposits for a long
4 period of time at extraordinarily low rates.

5 However, as rates rise, of course this
6 exposes to repricing risk. And to date, at least
7 in aggregate, we really haven't seen that much of
8 a repricing of deposit liabilities. It certainly
9 hasn't kept pace with the pace of rate increases
10 from the Federal Reserve. And so we all hear about
11 the deposit betas. They've been relatively low.
12 But at some point in time, that's going to be
13 unsustainable and there will be more competition
14 than we expected. The deposit pricing will start
15 ticking up.

16 So now looking at -- pairing that off
17 with the chart on the lower right. Community banks
18 have been increasing their percentage of long-term
19 loans and securities. And for this purpose, when
20 we say that, it's really for those loans or
21 securities that re-price or mature in more than
22 three years.
So in 2010, community banks had approximately 37 percent of their total assets that repriced in three years or later. That's now increased to approximately 50 percent. It appears to have plateaued. It appears to have leveled out at this point in time. But it's grown significantly since 2010.

So pulling those two together, the story we have is increasing interest rate risk, with community banks having gone out longer on the interest rate curve on the asset side. And then having more deposits that are susceptible to repricing quicker. So it's certainly an area that we're focused on. And I know the supervisory attention I wanted to highlight for you.

So that's the community banking performance. I'm happy to take questions now, or I can hand it over to George and we can handle questions in whole. All right, George?

MR. FRENCH: Thanks. All right, well good afternoon.

MEMBER TURNER: Sorry. So given what
you said, as you hear back from examiners that do
the, you know, sensitivity examinations at banks,
are you hearing that there are a lot of banks that
are actually liability sensitive when you, you
know, include the effective beta factors and other
items?

MR. MITCHELL: You want to take a shot
at it George?

MR. FRENCH: I'm sort of sitting here --

MR. MITCHELL: George gets to wear two
hats. He gets to wear two hats.

MR. FRENCH: So I used to be in
full-time job supervision. So clearly interest
rate risk is a big focus of our examinations. And
you know, I would say we've been pretty pleased with
the fact that institutions seem to be, you know,
taking heed of the supervisory findings. And I
think we have sort of an outlier type approach where
we look at institutions that are more exposed in
terms of maturity gap. And we're starting to see
that come down a little bit in terms of the trend.
So I think institutions are clearly paying
attention to the risk.

So with that, I can jump into the next
deck which looks like this. It should be right next
to the deck that Pat just went through. So clearly
we have strong bank performance at this time.
According to the National Bureau of Economic
Research, we're currently in the second longest
U.S. economic expansion since the Civil War. So
times are pretty good. Of course, we saw times were
pretty good before the last crisis. So you know,
we thought it would be interesting to look at some
of the similarities and some of the differences.
How does the current expansion for banks -- for
community banks -- compare to the last expansion?
And, hopefully, provide some food for discussion
around the table.

So looking at the first slide, which
deals with capital, you know this is clearly an area
of strength for community banks. This chart is
sort of a now versus then comparison. So you see
you a dark blue line which is the leverage ratio for
community banks in the last four years. The light
blue line is the ratio before the crisis -- the four years before the crisis. So you sort of see the two time periods are stacked one on top of the other on the horizontal axis. That will be the format for a number of these slides.

So, basically, community banks are operating now with a percentage point more in terms of their leverage ratio than they did before the crisis. It certainly dipped during the crisis about 70 basis points, but it's since rebounded strongly. And it's now one of the areas of strength for the industry. In part because of the fact that they have higher capital, their measured concentrations of commercial real estate and construction are now lower than they were.

So we'll go onto the second slide. So this shows the percentage of community banks that either had commercial real estate or construction lending concentrations -- commercial real estate greater than 300 percent of capital or construction lending greater than 100 percent of capital. You can see that at the peak, 32 percent of community
banks had CRE concentrations, 26 percent had construction lending concentrations. And those numbers have come way down.

So, for example, now only 6 six percent of community banks have concentrations in construction lending exceeding 100 percent of capital. So again in part because of the increase in capital, those concentrations are going to go down. But it's also just that the concentrations have come down. A number of institutions were burned during the crisis. And the concentrations are significantly down, even for those that have the concentrations, the levels of concentrations are lower. Now I do want to point out that it is not the case that banks are not lending in these categories. I'm going to come back to that a little later.

Going on to Slide 3, and Pat touched on this. One of the factors that's been supportive of net income performance during this current cycle has been the plentiful low-cost deposits. So this slide, for example, shows the percentage of
deposits that are non-interest bearing. And again, the dark blue line being now. -- light blue line before the crisis. Significantly more non-interest bearing deposits now. And that helps the bottom line.

And of course the flip slide, and sort of the potential for a two-edged sword, is that banks have -- those banks that have gotten used to this and have come to rely on it, as interest rates start to rise and deposits start to re-price or they leave the bank if they don't get the higher price, that creates either a squeeze on net interest margin or potential for deposits leaving the bank.

And we'll go on to the next slide, which sort of is a spot to elaborate on some of these issues. Slide 4. And this really simply reinforces what Pat was saying about the maturity mismatch.

So the dark blue line and the light blue line represent the portion of assets with maturities greater than three years that are funded with liabilities that are less than three years in
maturity. And you can see there's about a 15 percentage point difference. There's significantly more long maturity assets today than there was during the pre-crisis period. And of course that raises the prospect again as interest rates increase, those long-term assets, they're locked in. They're not going to re-price.

And so as the deposits increase in cost, that puts a squeeze on the spread. And then potentially those long-term assets will decrease in value as rates rise, which also creates a liquidity issue potentially.

So again, just simply reinforcing what Pat was saying. I think clearly it points at when we're looking at similarities and differences, interest rate risk is one of the more -- is one of the challenges in the current environment that maybe wasn't as prevalent during the last cycle.

Going onto to credit risk, which is you know, last but not least. And this is Slide 5. So notwithstanding that I just got through saying that concentrations in commercial real estate and
construction lending are down relative to capital, nonetheless, the overall volume of loans and loan-to-asset ratios are now a little bit higher than they were before the crisis, surprisingly enough.

And it really is in a number of areas, you know, I think one-to-four family non-farm, non-residential continue to be important. The composition of loans today at community banks, more than half are collateralized by real estate, which is same as it was before the crisis. A little less construction now. A little more general commercial real estate.

So you see here, you have more loans. I didn't show that there are fewer investments, but in fact, there's also less liquid assets. So more loans, less investments, a little more credit risk, a little more liquidity risk. And I think probably it's a function of the low interest rate environment. The banks are looking for higher yielding assets to shore up earnings.

So again reflecting on comments that Pat
made, I think the story on lending has mainly been
the loan growth in the last few years. And I'll
turn to Slide 6.

So lending at FDIC-insured banks in
general has been outpacing GDP growth for some time.
But it's particularly true for smaller banks. And
this chart deals not strictly with community banks
but all those banks with assets less than 100 billion, which includes both community banks and
many of the banks that community banks compete with.
And you can see that all these banks are on average
growing their loans pretty strongly relative to
GDP, which is the bright red line. They're all sort
of trending up strongly in lending.

So I think, by dollars, most of the loan
growth in this chart is coming from one-to-four
family, especially from commercial real estate, and
from C&I. Those are the big categories that banks
hold. And that's those are where most of the
dollars of growth are coming from.

Some of the notable smaller categories
that are growing very fast would be ADC or
construction lending, which is kind of rebounding from its low. It kind of dipped sharply after the crisis and now it's starting to come back. And multi-family residential real estate is also again a small category that's growing pretty fast.

And so the question that this kind of growth raises is what kind of risks are banks taking to achieve this growth? So some of our FDIC publications in the last couple of years have pointed out trends such as an increase in the frequency of out-of-area lending. An increase in the use of non-core funding by banks that have loan concentrations in commercial real estate or agriculture. So these are some of the signs that we're seeing that, you know, there are some risks being taken out there.

The big question is how these risk behaviors are going to intersect with the external environment. And in particular, the environment for real estate. Because that's --, as I said, that's what many community banks really specialize in is real estate lending.
So turn to the last slide. So this slide shows the inflation-adjusted price trends for three types of real estate: agriculture, which is the green line; commercial real estate, which is the blue line; and one-to-four family, which is the black line. And these are inflation-adjusted in the sense that if these property prices were tracking along with inflation, these would all be horizontal lines at 100.

So you can see that agriculture, for example, has really seen some significant price appreciation since about 1990. --sort of a long-term upward trend. Commercial real estate, strong upward trend since the last recession -- since the end of the recession. And one-to-fours are starting to show some pretty healthy price appreciation since about 2012.

So you know, whenever you see these kind of sustained price increases, you always get the question of vulnerability to a correction. You know, where are the vulnerabilities? And given the importance of real estate loans to community banks,
you know, this clearly sort of just draws an underline of the fact that prudent risk management of those portfolios is very important.

   Since I'm just the acting chief economist, I'm not going to try to tell you where the bubbles are. I was hoping I could throw it open and, you know --

   CHAIRMAN MCWILLIAMS: Could you tell us where the acting bubbles are?

   MR. FRENCH: So I thought we'd throw a -- you know, a good place to stop. I'd be interested in your comments on any or all of the above. Deposit pricing, underwriting trends.

   MEMBER TOLOMER: I think this is very insightful. One of the things that I worry about is when I look at the two-to-ten, it's now 27 basis points. It looks to me like it's either going to be a flat yield curve or worse, inverted yield curve.

   MR. FRENCH: Yes, that would be -- that would not be a great development for income. It would not.
MEMBER TOLOMER: But, I mean, it's been falling. It was up 100 basis points -- two-to-ten was up more than 100 basis points not so long -- you know, a few months ago. And that portends what, a recession, right? I know you're acting.

MR. FRENCH: Yes, it's traditionally one of the warning signs of a recession. Of course again, we've had a very long expansion going on nine or ten years.

MEMBER TOLOMER: Right.

MR. FRENCH: But --

MEMBER SCULLY: In a low interest rate environment --

MR. FRENCH: Yes.

MEMBER SCULLY: -- which changes so many of the pressures on companies in particular. They don't live in the same debt service pressure that they would have.

MEMBER TOLOMER: Right.

MR. FRENCH: Do you have a lot of variable rate borrowers or do you know of --

MEMBER SCULLY: Not as many as I'd like
to have --

(Laughter)

MEMBER TOLOMER: Well, we're asset-sensitive and we do have a lot of line of credits that's pegged to prime. But, like Mary Ann said, not enough.

MEMBER SCULLY: So those low rates, I mean, I think that's a huge part of the long recovery is that, you know, companies haven't felt that pressure from interest rates that they traditionally have. And some of it's the interest rates, and some of it's also that all of us have fallen victim to -- a lot of those fixed rates happened to keep them --

MEMBER TOLOMER: Well, and I think when you speak to a customer about five-year money being a 5.25, there's a real shock sticker shock that, you know, 5 five what? You know, and it's going up 5.25, 5.50. Ten-year money is more expensive. So there is a certain amount of our prospective customers and customers certainly in my market where when you start talking about 5 percent, you
know, they get palpitations. So it's going to be an interesting thing with --

MR. FRENCH: Yes. You read a lot about high leverage in the corporate sector, which is, you know, the syndicated loans and all that.

MEMBER TOLOMER: Right.

MR. FRENCH: You know, which is sort of a big bank issue. But, I mean, do you have any concern about borrowers at sort of the smaller business or mid-size being over leveraged or --

MEMBER TOLOMER: They've been more optimistic and I think that they've been utilizing the tax cut to fund some of their expansion. I think some other people have had different experiences. But in the New York metropolitan area, we see loan demand. There's more refinance opportunities in my estimation than business expansion. Because I think a lot of the business expansion is being funded by the tax cut. So --

MEMBER SCULLY: They're using liquidity.

MEMBER TOLOMER: Exactly correct.
MEMBER SCULLY: They're all using more liquidity. There's no rising tide. I mean, as community banks, we all get to, you know, arithmetically we can still grow just by taking market share. We don't need a rising tide because of our asset sizes.

MEMBER TOLOMER: Right.

MEMBER SCULLY: But it's a good thing because there is no rising tide, I feel. They're not -- you know, I don't think they're changing their behavior --

MR. FRENCH: Loan demand, you're saying, is not --

MEMBER SCULLY: It's refinancing.

MEMBER TOLOMER: Yes, I think there's refinance and certainly in the New York metropolitan area, the greater fool theory is beginning to prevail. So multi-families are still in some cases -- rates are below 4 four percent. You know they've got to be doing that with magic or pixie dust. Because it just doesn't add up to what your cost is.
So there's that level, and a community bank like ours wouldn't play in that arena because it's just -- we can't afford to do that. But I think -- and we have a fair amount of C&I business and we see pockets of very successful businesses that are looking to expand and have utilized their liquidity. And some that are, you know, bumping along better than they were, but not this vibrant economy you see on CNBC or Squawk Box.

MEMBER WILLIAMS: That's interesting because we are seeing that vibrant economy. We're in the Salt Lake area. And loan demand, it's liquidity and a deposit gathering result. We can make as many loans as we want to. And it's market driven. It's not necessarily competitive. All the banks are doing well. It's kind of scary, it's been going so well so long. But you know, if you fly into town, all you see are cranes and continued growth. And this is year 41 in the business for me, and I'm beyond the nervous stage because they never last this long, this good. So --

MEMBER BAER PAINE: We are seeing that
vibrant growth, as well.

MR. FRENCH: Where is your bank? I'm sorry.

MEMBER BAER PAINE: Bemidji. Say it, you can do it. Northern Minnesota.

MR. FRENCH: Oh, okay.

MEMBER BAER PAINE: Four hours north of Minneapolis. So really in a rural area, but kind of a regional center. But we are seeing that continued growth and demand in both the housing and the commercial.

MR. FRENCH: That's great.

MEMBER DONNELLY: I am from Kansas City and we've started to see the effect. And we're not at 5.25. We're at 6six percent. But that is starting to deter borrowers and they're actually not taking. There's plenty of demand but the interest rate is starting to push -- We're getting push back from borrowers and they're not taking on debt. Which I think that's something the last time, I don't think borrowers -- they didn't care what the rate was. Before '08, they'd just give it
The borrowers now are maybe even better borrowers -- we are just this last quarter. But of course, also even at that rate, because of our funding mechanism, it's the last bit of growth and not making the same money. So there's no reason to grow. Because the spread is so narrow, it's not worth adding on unless you can get the loan spread way up. But we've seen that effect, which really surprised me. I thought maybe they'd go on a little bit beyond 6 six percent. But this seems to be a threshold that borrowers aren't willing to go over.

MR. FRENCH: Are depositors starting to ask for, you know, where's my 25 basis points, or whatever?

(Simultaneous speaking)

MEMBER WILLIAMS: For the last 60 days --

MR. FRENCH: Okay.

MEMBER WILLIAMS: -- in our market, we've seen movement.

MR. FRENCH: Okay.
MEMBER WILLIAMS: Pretty dramatic movement actually.

MR. FRENCH: Interesting.

MR. MITCHELL: Have you seen people actually -- if they don't -- if you're not meeting their demands, people pulling deposits?

MEMBER WILLIAMS: Oh, absolutely.

MR. MITCHELL: Okay.

MEMBER BAER PAINE: They're shopping for sure.

MEMBER DONNELLY: It's been a long time since they were shopping.

MR. MITCHELL: Right, right. They've been very slow, right, broadly speaking?

MEMBER WILLIAMS: We've been at a point of indifference for years.

MR. MITCHELL: Right.

MEMBER WILLIAMS: And it appears that we've busted through it. And, you know, we're in a state, too, that's probably a huge percentage of our market are credit unions. So that has a factor on our pricing as well.
MR. MITCHELL: Sure.

MEMBER BAER PAINE: So, and that affects us, as well. We have ten financial institutions in our town and two are credit unions in a town of 14,000. And what we have, there's a lot of competition out there for both loans and deposits. So you see some sub-prime lending and you see some pretty big rates to get those deposits, too. So you really have to manage your portfolio on a regular basis.

MR. MITCHELL: Are you expecting -- so the way I view it is it's greatly lagged. And now are you anticipating there's a catch-up and then plus then matching the next rate rise or --

MEMBER BAER PAINE: Yes. We've done different things like five-year specials --

MR. MITCHELL: Okay.

MEMBER BAER PAINE: -- and put some bigger rates out there. And just again kind of managing your A customers. You're going to give them the best rates that you can --

MR. MITCHELL: Sure.
MEMBER BAER PAINE: -- whenever you can. But you have to deal with --

(Simultaneous speaking)

MEMBER TOLOMER: It only takes one or two in the market. So you have somebody -- we were at a function at the Fed and another CEO sat and he said, “Boy you can't imagine what a 1.6 percent money market does for your business.” Well, sure everybody else is at 80 or 90. So you know, then it starts the whole chain of, well, what about CDs? And so some of the larger banks need liquidity, as do all of the banks. And so they raised their rates, and then consumers are pretty bright. They come in and say well “Well, if I can get that there, why can't you help me here?” And so the game is on.

Now there's been six moves for the Fed --

MR. MITCHELL: Right.

MEMBER TOLOMER: -- and we've probably moved a couple of times. But there's no question, there's pressure on deposit rates.

MEMBER WILLIAMS: We're seeing
something interesting, too, on the curves. You know, basically we talked about a relatively flat yield curve. The deposit curve in our market is -- it's up 250 basis points swaying over five years, which is --

MEMBER SCULLY: But will anybody do the five years?

MEMBER WILLIAMS: -- perplexing.

MEMBER SCULLY: What we're finding is all the competitions between 13 and 26 or 27 months, you can't get it -- We can't get a consumer to go out longer than two years.

MEMBER WILLIAMS: Yes, we've lost some to credit unions that are paying 3.25 five-year.

MEMBER MENON: I'm from the Las Vegas market Vegas market, and what we're seeing primarily is the local banks are pretty good in pricing the supply. It's the Synchrony Bank. I don't know if you guys see those ads all the time.

MEMBER BOEKA: Yes. We have the same thing in southern California.

MEMBER MENON: In the local paper, you
know, which advertises significantly higher rates than local banks are willing to pay. And obviously the consumer looks at it and says, “Hey, this is what I can get. Can you match it?” So we're seeing more of that. But the Vegas market has been pretty disciplined in its pricing standpoint.

But we also have a branch in Phoenix. Now Phoenix is a very hot market from the standpoint of gathering deposits. The rates are much higher and a lot more banks competing for it. And so we see an anomaly between Nevada and Arizona from that standpoint.

MEMBER WILLIAMS: Interesting.

MEMBER TURNER: Have you analyzed this property value slide -- the last slide you went over, you know, as to what's going on? Is this a result of NOIs being up? Is it a result of cap rates coming down? Do you have a feel for what's going on there?

MR. FRENCH: So I'll give you my secondhand. I mean, the agriculture -- there was a significant period of prosperity in agriculture
that probably came to an end about four years ago. And there's been a sense a, you know a real stress in the sector. But the land prices are still, I'm told, holding up. They don't come open -- land doesn't come open for sale very often. You know, maybe once a generation, or even less, so the prices are so far holding up.

The black line on 1 one-to 4- four is an FHFA index of sort of repeat transactions from across the country. So it's a pretty good sort of widespread barometer of U.S. housing prices. Not as sensitive as the Case-Shiller, for example.

MEMBER TURNER: Right.

MR. FRENCH: But, you know, my understanding is the supply of housing is an issue and sort of the prices are probably driven by --, you know to some extent, by limited supply.

MEMBER TURNER: Right.

MR. FRENCH: And then this blue line is an index of sort of institutional investors’ total returns on real estate. And it is what it is. I can't say -- I mean I've heard certainly people say
cap rates are pretty low.

MEMBER TURNER: I think that's right. I mean I think cap rates are low, you know, just on a real basis. And I think they're probably fairly low even when you -- you know as a spread to the 10-year Treasury or something.

MR. FRENCH: Right.

MEMBER TURNER: I think, you know especially on certain types of property like really, you know trophy multi-family property or shopping centers in really big markets. It seems like the cap rates are crazy low on that kind of thing.

MR. MITCHELL: And we haven't decomposed this slide into each of its components. I think it would be very difficult. But there is one part that I think you pointed out here. Is that over this time period, we've been in a generally downward trending interest rate environment with some bumps up along the way.

But it's been, you know, a 30-, 40-year long-term trend down that at least supported some
of this valuation increases. So there's a lot of
-- there's a lot at work here. I think this is
intended to really say there have been some
significant increases. Let's make sure we're
being really careful, you know, from an
underwriting perspective and aware that it can't go
on like this forever.

MR. FRENCH: Right.

MEMBER DONNELL: If you don't mind
Patrick, go back to your slide, Number 5 -- Page 5,
the bottom loan and lease balance. And really
curiosity more so. I mean, the overall industry
trend in loan growth is slightly up.

MR. MITCHELL: Slightly. Flattish to slightly up, right.

MEMBER DONNELL: And then you show
pretty good growth in the community bank. But the
community bank probably size-wise doesn't make much
impact to the overall. So if you took the community
bank out, I mean, and leave the big banks in there,
have they moved at all in --

MR. MITCHELL: So let's just say, to
your point, if you remove the community bank out of this, it really doesn't move materially because it's still -- yes, I mean it moves it so little from terms of weighted averages --

MEMBER DONNELLY: Yes. I figured that's what it was. I just wanted to confirm it.

MR. MITCHELL: Yes, the rest of the industry, I would say, has been essentially -- it's been flat.

And, in fact, one of the things that George noted here on his -- when he talked about loan growth, -- you'll note that the one group that is not in there is the 100-plus. So their loan growth has actually been very flat and lower than GDP, at least at the largest institutions.

MR. FRENCH: So this bottom-right of Slide 5 is loans-to-assets. It's not loans. So, loans-to-asset flat. It's different from loan growth.

But, in any case -- yes, I think the industry as a whole has been growing loans faster than GDP. But certainly --
MR. MITCHELL: That's definitely --

MR. FRENCH: Certainly the smaller banks are growing the fastest.

MR. DAVIS: Okay. With that, I'll try and keep us on time again.

DIRECTOR GRUENBERG: Can I ask one question before we go because it would --

MR. DAVIS: Sure.

DIRECTOR GRUENBERG: This has been a terrific discussion. I really thank you. There seems to be -- it's my perception and keen sensitivity among you all that there really -- the potential for inflation point in the economy is very much on your minds. And a risk factor for you all to pay close attention. At least, that's my perception from the discussion today. Do you think that's generally shared by your colleagues among the community banks that they understand there are vulnerabilities here? And that we have an environment that may be shifting at some point?
MEMBER TOLOMER: I think it's -- yes. I think the answer is yes, but I think it's expressed differently. I think it's expressed in terms of liquidity and cyber security as opposed to economic pressures. I feel all three.

DIRECTOR GRUENBERG: Okay.

MEMBER TOLOMER: Okay? You know which is the economy. When you see the two-to-ten, that can't bode well. And you know, irrespective of what you see on TV, that's my feeling. And I think -- We were talking about it at lunch -- cyber security, you know, clearly is an issue. Liquidity is an issue.

And I think the comments that Len made about making loans, it is easier to make loans, whether they're refis or they're expansion. But the deposit base is more difficult and more challenging. And I think that's an industry issue. So I think there's greater sensitivity. It may not be necessarily tied to economic pressures.

MEMBER TURNER: I think there is. And I think that's something that the FDIC can do as you
examine banks, just as you -- you know, you have the
discussions. Just reinforce the fact that we're a
long way into an economic expansion. I think that
can be helpful.

MEMBER WILLIAMS: From a community bank
perspective, I think it's an interesting time from
the technology perspective as well. We're in a
market that has a lot of the ILCs, industrial,
industrial loan companies, that are deposit-
gatherers without brick and mortar. And seeing
what they're doing is pretty innovative.

And we're seeing the deposit loss.

We're not losing the customers. But in many cases,
we're losing depositors to the -- some of the
fintech type. But also the online big banks. I
mean Goldman is a great example. They've got a
whole different price model than we do. And when
people see that, now that we're past that inflection
point where there's interest -- no pun intended,
-- we're seeing some movement for the first time in
a long time.

And then you see some of the threats and
the discussions from the Apple-Amazon-Facebook-Google world. I think there's a legit threat out there to deliver the low cost from a community bank. Kind of a high-cost-delivery methodology to some of the alternatives that are coming out there. So I think deposits aren't going to get easier.

MEMBER KELLY: Martin, to speak to your question. I think what I'm finding is, is kind of disturbing in that I've heard this before about ten years ago. And that, you know, not in my backyard. You know, it's bad. Something's going to happen, but not to us. So you see, that's what's gotten me really concerned because they're continuing to go headlong into multi-family, all this stuff that I just think is overdone.

And at some point, you know, I think the two-ten is something you do have to pay attention to. Those are very smart people with lots of money. And you know, the bet is that we're going to see some inflation of some kind. And if so, then who's going to get hurt?
But yes, from a community banking perspective, I would say the folks that I've talked to, they'll give me five minutes of that and then 55 minutes of why business has never been better. You know, and the fact that they're going to build a Taj Mahal or whatever. And I'm like, okay guys, you know -- we're getting further -- I mean you guys have been here. You all understand. You get further from the fire, you forget the heat.

DIRECTOR GRUENBERG: Thank you.

MR. DAVIS: Thank you. Okay, for the next panel, we're going to keep Diane and Matthew Green will be joining us. Matthew's the associate director of Financial Management and Reporting -- I'm sorry, Financial Management Reporting in the Division of Insurance and Research. And Diane and Matt are going to talk briefly about assessment credits.

MS. ELLIS: All right. Thanks, Chad. So this agenda item is here because David asked us a question after we briefed our Board, I think in the spring on the condition of the deposit insurance
fund balance. I appreciate the fact that David keeps a close eye on our deposit insurance fund balance and the reserve ratio. He always greets me with the latest fund balance and reserve ratio. And I'm appreciative of you.

Anyway, he thought, you know, Diane, I really feel like we should talk about the assessment credits that we --

MEMBER HANRAHAN: Typically because I don't understand it.

MS. ELLIS: That's what this is for. The assessment credits that we are I guess awarding banks as we build up our reserve ratio from 1.15 percent to 1.35 percent. So I brought in Matt now for reinforcements here. And he's going to describe how that's going to work.

MR. GREEN: Sure. So before turning to credits, I think it would be helpful to briefly review the current outlook for the deposit insurance fund. And some background information on why community banks will receive credits.

So the deposit insurance fund balance stood
at 95.1 billion dollars on March 31st. That's a 
10.1 billion increase over four quarters. The 
reserve ratio, which is the fund balance as a 
percent of estimated insured deposits was 1.3 
percent on March 31st. And that's up from 1.2 
percent in March of last year.

The FDIC staff expects that the reserve 
ratio is likely to reach the statutory minimum of 
1.35 percent in the third or fourth quarter of this 
year. And that's two years ahead of the September 
2020 deadline required by the Dodd-Frank Act. 
After the deposit insurance fund surpassed 1.15 
percent in the second quarter of 2016, regular 
assessment rates declined, as called for under a 
rule that the FDIC Board originally approved in 
2010, and then reaffirmed in 2016.

When the lower rates went into effect in 
the third quarter of 2016, quarterly assessments 
paid by banks with less than 10 billion dollars in 
assets declined on average by about one-third. The 
Dodd-Frank Act requires, however, that banks with 
total assets of 10 billion dollars or more, bear the
cost of the increase in the minimum reserve ratio
to 1.35 percent from the previous legal minimum of
1.15 percent.

So since the third quarter of 2016, large banks have been paying temporary assessment surcharges. In addition, small banks will receive assessment credits for the portion of their assessments that contributes to the increase in the reserve ratio from 1.15 percent to 1.35 percent.

The final rule that we adopted in 2016 requires that we notify each small bank of the amount of credits that it will receive as soon as practicable after the reserve ratio reaches 1.35 percent.

So, calculating the total amount of credits will require information that will become available only after we've reached 1.35 percent. That information includes the amount of insured deposits at that time, the total amount of surcharges that large banks paid toward growing the reserve ratio, and the proportion of regular assessments that were contributed by small banks.
So as I mentioned earlier, credits are going to be assigned to small banks based on their contribution to increasing the reserve ratio from 1.15 to 1.35 percent. So in developing the rule that provided for credits, we had to make assumptions about which funding sources would increase the reserve ratio from 1.15 to 1.35 percent, as opposed to maintain the fund at 1.15 percent.

And the calculation in our rule assumes that the fund's investment income, as well as any reductions in losses from bank failures, will be used for fund maintenance to maintain the fund at 1.15 percent. We assume assessment revenue is needed for this purpose only to the extent that other funding sources are insufficient.

So essentially this method attributes reserve ratio growth to assessments as much as possible, therefore maximizing the total amount of credits that small banks will receive. And I would add, we rarely get favorable comments on proposed rules. And that was one of the rare instances where
So the total credit amount will also depend on the quarter in which the reserve ratio reaches 1.35 percent. We currently estimate that the aggregate amount of small bank credits will be between a half a billion dollars and one billion dollars. The FDIC is going to allocate the credits among small banks in proportion to each small bank's average assessment base. Just roughly, it's total liabilities during the time that the reserve ratio was between 1.15 percent and 1.35 percent.

When the reserve ratio is at or above 1.38 percent, the FDIC will automatically apply credits to reduce the small banks assessment up to the entire amount of that assessment. And we expect that, for most banks, credits will fully or partly offset their deposit insurance assessments for three or four quarters.

So with that, I'd be happy to answer any more questions.

MS. ELLIS: It was hard to figure out how much detail to talk about this issue. We tried
to strike the right balance, but tell us if we got it wrong and we need to do any follow-up here.

MEMBER HANRAHAN: Well, your last comment was the punch line. You expect it to --

MS. ELLIS: Yes.

MEMBER HANRAHAN: -- party or fully cover three to four quarters.

MS. ELLIS: That's right.

MEMBER HANRAHAN: That's a lot.

MS. ELLIS: Yes.

MEMBER WILLIAMS: Define small banks for this purpose.

MR. GREEN: Generally banks with 10 billion or less in assets.

MS. ELLIS: All right. Hey, there you go. Happy news. So as a follow-up, I do understand that at the end of the session right before lunch, some questions came up about the small bank pricing methodology and assessment appeals, so forth.

If it makes sense, we'd be happy to come back at the next meeting that we have, which is just
going to be in three months and talk about the small bank pricing methodology. It's been in place, you know for a couple of years now. We can talk about, you know, what it is and what some of the effects are. And maybe that would answer some questions. And would be happy to answer any other questions now or offline.

MEMBER SCULLY: I think it would be great if you came back and did that. Because I know recently we've just gone through an acquisition, and so we're taking a look at our much larger assessment and trying to figure out the components. And, you know, it came back to the asset mix being --

MS. ELLIS: Yes.

MEMBER SCULLY: -- more of the weight than our CAMELS rating. So I'd just be interested in like how typical that is, or atypical that is.

MS. ELLIS: Okay, sure. Yes. That would be easy. We would be happy to do something like that. Okay?

MR. DAVIS: Okay.
MS. ELLIS: Good.

MR. DAVIS: Okay, we have a break on the agenda next. We will resume again at 2:45 and hear from the Ombudsman at that point. So thank you.

(Whereupon, the above-entitled matter went off the record at 2:28 p.m. and resumed at 2:42 p.m.)

CHAIRMAN MCWILLIAMS: All right, so we're back for the Ombudsman update. And I understand it's been a while since you have had an update from the Office of the Ombudsman. And what I would like to do unless, you know, I hear otherwise is to basically include an update from the Ombudsman at every meeting. Because we're trying to make this process of what the Ombudsman does and the function as robust as possible. And your feedback would be very welcome in that process. Unless you think there's a better way to use up 15 or 20 minutes, you know, I'll make sure that we have the Ombudsman update at every meeting.

All right, I like when nobody disagrees. That's good. Go ahead.

MR. LOWE: Do I get a vote?
(Laughter.)

CHAIRMAN MCWILLIAMS: No, that was not an option.

MR. DAVIS: Okay. Anthony Lowe is the Ombudsman. And I will not add to those remarks anymore, and just turn it over to you.

MR. LOWE: Okay. Thank you, Chad. Good afternoon, everyone. I want to just talk with you briefly this afternoon about the Office of the Ombudsman here at FDIC. Talk a little bit about our operations. Where we get the majority of our information, how we do reporting up the line to the Chairman's Office, and some of our objectives that we have set forward for 2018. And some of them will carry over into 2019.

Just for a little bit of historical perspective, the Ombudsman Office was established in accordance with the RiegleCommunity Development and Regulatory Improvement Act back in 1994, which required all of the bank financial regulatory agencies to establish a liaison that was independent of the main operations of the offices.
that could serve to listen to issues, concerns, -- whatever the case might be -- that pertain to the regulated entity. If they had concerns about the operations, about, you know, the oversight, they could bring those questions, those concerns to the FDIC.

When you think about a definitional standpoint, if you go to the second slide, it pretty much gives you the major tenets of an ombudsman office. And these have been established by the Administrative Conference of the U.S., which established guidelines for ombudsman standards.

And the major tenets that we have here are that we're independent. We're neutral. We're confidential and we're informal. And just to give you a little bit of perspective on each of those from an independence standpoint, my office reports directly to the Chairman's Office. We do have periodic discussions with some of the division directors and other parties here at FDIC. But from a reporting standpoint, we do report directly to the Chairman's Office.
We're neutral in that we do not advocate for the FDIC or any of the stakeholders. -- that being banks, trade associations. Whoever brings a matter before us, we advocate for a fair process.

We're confidential. That means any of the matters that are brought to our attention by the stakeholders, we do keep it confidential unless the stakeholder has given us the authority to discuss their individual matters or their individual names. The majority of the reports that we produce, we do not indicate bank names because we do want to maintain that confidentiality. Again, unless it is a unique matter that we think we do need to take it further and we do need to do some additional review. And we do get the concurrence of the party that's bringing it before us to do so.

And we're informal. We try to find a collaborative resolution to any issues or problems or concerns that have been brought before us. We do not get involved in the formal appeals process at this particular point in time. We do not have the authority to change regulations, to change
statutes, or to change decisions. So again, we do operate in an informal basis at this time, and try to resolve issues at the lowest level. And at the most soon possible -- as soon as possible as it's brought before us.

When we talk about the role of the Ombudsman, if you go to the third slide. A big part of that is just providing an FDIC perspective to the stakeholders. And when I say stakeholders, I'm talking about bankers, the public, trade associations, and also other regulatory authorities.

As I mentioned, a big part of what we do is providing feedback to the Chairman's Office. We're always on the lookout for any potentially systemic issues. And when I mention systemic, those are issues that, from my office standpoint, we continue to see issues that come up almost routinely on a daily basis when my staff is out visiting with banks. Or, that we've indicated that a majority of the banks or we think a majority of the banks have some level of confusion with regard
to what it is the agency is requesting or what the expectations are. So we're always on the lookout for potential systemics.

We do work with other divisions to address issues that might be raised, and encourage improved policies and practices. And we do help to facilitate or try to help facilitate effective communications between the agency and stakeholders. And again, the majority of those are banks.

I think one of the major tools that we have in our toolbox is being able to facilitate communications between the right people at the bank with the right people at the right level at the FDIC to get issues resolved. So that's a major tenet of my office.

If you look on Page 4 or Slide 4, it gives kind of a brief overview of our org. chart with me as the director. I have an associate director position that will be filled soon. I have regional ombudsmen, -- six of them. -- one in each of our regions around the country. And here in
Washington, I do have a small staff of senior ombudsman specialists.

Just for a little context, the regional ombudsmen, on a daily basis for the most part, are visiting banks around the country. On average on an aggregate basis, we usually touch base with somewhere between 500 to 600 banks each year that we're on site. And that's outside of cases that may come to our attention because banks have called us and asked us to review or investigate a matter. So those folks are constantly out gathering information that we do put into reports periodically that do go to the Chairman's Office.

The senior ombudsman specialists here in Washington, again a small group, but they do handle all of the incoming mail, the email, phone calls. And we've been averaging for the last five or six years, about 2,000 inputs on an annual basis. And I'll talk a little bit more about what some of those calls are. And you know, what we eventually do with those. So a pretty busy office, you know, and a lot of inputs that come from a lot of different
If you look at Slide Number 5, it does give you some information about the groups that are contacting our office. And, of course, as you see here, close to 90 percent of the contacts do come from the public. A little bit of a dichotomy, the largest number of contacts do come from the public. But the majority of our time is spent on issues that are presented and cases that are presented by banks.

Some of these cases that do come from the public, some of them are very simple. People are asking about FOIA, they're asking about getting some records released. We oftentimes do get, you know, calls from individuals that had a loan maybe at a bank that has failed. They want to find out where they can get a title or get some information with regard to an estate that they need to settle.

And sometimes individuals do see us a last resort because they've gone through the civil actions. They have a dispute with a bank about a deposit or something that they think they've not been treated fairly. And they do contact our
office to see if there's any avenue or strategy that we can assist them with. And again, we do get about 2,000 of those on an annual basis.

The method of contact that we have for the most part is telephonically. Now, when you look at this chart on Tab Number 6, you know, I think I have to explain that there's a little bit of a waterfall effect. The majority of the cases do originate from a written -- I mean to say a written contact. After we get that -- I'm sorry, a telephonic contact. After we get that initial telephonic contact, oftentimes, the next step will be a written letter that will request some additional information. And then at the end of the day, oftentimes we do have a sit-down or a face-to-face meeting with the banks or the individuals that have brought the matter to our attention.

We do work with the other divisions around the agency, including RMS and DCP. Again, to try and identify potential issues or concerns, and trying to facilitate better practices and
policies. , and also to make sure that we can clearly articulate what our expectations are from a regulatory standpoint.

We do participate also with the Division of Resolutions on bank closings. And specifically, we do participate in putting together a Q-and-A guide as provided for closings. , and also assist with having discussions with bank customers after the bank closes. We also, from time to time, will participate with our communications group on putting together press releases. , and if needed, participating on some local media participation.

A couple other items that I did not put in the package here that we do participate on. Anytime that we do have a formal appeal that comes to the FDIC, after it's settled and gone through the SARC process, within 180 days after that is completed, whatever the decision is, we do go visit that institution. just to have a discussion with them about the process. -- if they have any suggestions for improvement. -- if they feel like
they were treated fairly. And then again, we do report that information up to the Chairman.

We also do visit with institutions that have converted either to the FDIC as their primary regulator or away from the FDIC. And we usually do that within 90 days after that information becomes available to us. Because we do want to know, you know, what was the mechanism? What was the trigger that made you want to either come to FDIC or to leave FDIC? And the majority of the time, those that do come to FDIC, it's because of cost and budgeting. They usually will tell us if they were a Fed member or national bank that the cost for operating from a regulatory standpoint is going to be a little bit less with FDIC.

They also often tell us the majority of the time that FDIC has local examiners that know the local market, and the majority of the bankers really do appreciate them.

I think I skipped one slide. This one's very -- excuse me -- very important. Slide Number 7 talks about frequently-reported areas of
concern. Approximately 60 percent of the items or
the matters that do come before our office are in
regard to the examination process. Some of them
are fairly simple. They call and ask why is the
examination taking so long? You know, why can't I
get closure with regard to an application that I
have outstanding? A lack of response, you know,
from one of the offices with regards to some
correspondence. So again, about 60 percent of the
calls or the cases are in regard to that.

We also get about 23 percent or 22
percent of our calls and cases in regard to the
banking environment. This is usually cases with
regard to the bank saying there's unfair
competition. They often raise issues with regard
to credit unions, farm credit, those type of things.
And they also raise issues with regard to
regulatoreregulatereg burden and Call Reports.
Those type of things. And the other two are
regulatory matters and banking legislation make up
the balance there.

For 2018, some of our major goals that
we've set for the office are to broaden industry awareness of the Ombudsman. And make sure that the industry, including individual banks and the trade associations, know what our office can do. Know what services that we can provide. And again, monitoring the feedback that we get from community bankers, -- I think it's extremely important.

Again, we're going to be looking for systemic issues and things that we might need to look and see if we can independently or do need to independently change any of our policies or our processes with regard to supervision of community banks.

And we're also in the process of developing a pilot program to start external reporting on our activities on an annual basis. Hopefully, to give some information, you know, from a transparency standpoint about the number of outreach events we've had, the number of contacts, what the contacts have been in regard to, and some trend analysis.

And each of you should have at your seat,
some contact information about the office. My business card has my direct phone number. And you know, definitely, I hope you will spread the word about the Ombudsman Office and the services that we can provide.

And I'll take any questions that you might have.

MEMBER HANRAHAN: Anthony, can I ask you a couple of questions about Slide 5, -- that pie chart?

MR. LOWE: You told me you weren't going to ask any questions.

MEMBER HANRAHAN: I said what you requested was easy ones, and I'll try and do that.

MR. LOWE: Okay.

MEMBER HANRAHAN: First a comment. I'm astounded that the vast majority of your contacts are from the public. I never would have guessed that. Doing some math, though, on the percentages, I think you said you have 2,000-ish points of contact inbound a year. So if 13 percent of those are from the industry, that means there's
260 or so from bankers. Are those 260 unique matters or -- because that seems actually like a lot to me -- or could those be multiple points of contact on one matter?

MR. LOWE: Yes, good question. Some of those will be multiple issues that bankers will bring forward to us. Oftentimes, though, when they make the initial contact with us, it will be one issue. It may be, you know, I'm not sure how the FDIC arrived at this, you know, particular rating. Can you help me look at the definition? And when we make the callback or have further discussion with them, they will often bring up another issue. Well, you know last year, my numbers were here. They're the same this year, and I'm not understanding the metrics as to why there was a downgrade or a change in the supervisory strategy. So some of these, you know, there would be some waterfalls there.

MEMBER HANRAHAN: Thank you.

MR. LOWE: Yes.

MEMBER SCULLY: So I think it's a
wonderful assistance to everybody to know that you're there. But I've always been curious about how do you resolve from a process standpoint? You know, handling a transaction, handling a communication, the inherent conflict between confidentiality, and closure of the issue? Somebody's complained to you,. How do you resolve that? I mean, if it's just an informational question -- but if it's actually a complaint, how do you resolve that and maintain confidentiality?

MR. LOWE: You know oftentimes, again because my regional folks are out on a daily basis and I do get weekly reports. And oftentimes, they'll have similar issues that have been brought forward. You know, if there's a new FIL that has been issued and there's some concerns about clarity as to again, what the expectations are, when I do meet with the division directors of RMS or DCP our or Resolutions if the case, you know, dictates that. I will just present hey, I've been getting consistent questions, consistent you know concerns about this particular issue from A to Z. and try,
again, to mask the identity of the individual institution.

Sometimes we do get cases that come in that we do have to tell the bank that we cannot resolve that without releasing information, e.g. Especially those in regard to applications that they think have been, you know, been sitting for too long, or they can't get a response as to why it hasn't been resolved.

MEMBER SCULLY: Okay.

CHAIRMAN MCWILLIAMS: Anthony, it may be helpful if you walk us through the mechanics of, say, a bank calls up and says somebody from the bank says, you know, we just had an exam and we believe the examiner is going to retaliate against us. What do you do from there?

MR. LOWE: Yes, when we have a case that comes in and that does occur. I won't say it's often, but we do have that occur from time to time. Usually we'll try to get some additional, more granular information from that individual, the banker. You know, sometimes we will ask one of our
regional folks to go out and visit with that individual bank. And, you know, try and get some more information. Is there something tangible that you can show us that clearly, you know, shows that there was, you know, potentially intimidation, or why you would be intimidated?

And then usually we'll get into the records of that particular bank and try and see if there's anything in the written record that appears to be inappropriate or that may be outside of policy. And eventually we will usually have a discussion with the division managers if it's risk management, you know, with Doreen Eberley and her staff, or if it's on the compliance side, with Mark Pearce and his staff. So it is a, you know, gradual step-by-step process that we go through. Again, not advocating, and we don't immediately say that either side is right or wrong. But any case, especially like that, that we get, we do take it seriously from the beginning, and we set up a strategy to see how we can determine has there been an issue here? Has there been, you know, why does
the bank feel intimidated?

One thing also that when my regional folks go out on a daily basis and when I do visit with trades, I always make sure and talk to them about the examination surveys. I tell them, this is a good way to do feedback to the FDIC. You know if you had an issue with regard to the professionalism or that, you know, some matters were not clearly explained to you during the course of the examination, use that survey.

But, also, we always tell them, the best source for you to try and resolve issues is to talk with the examination personnel, you know, at the local level. The majority of the time -- often times we do find it's just a matter of, you know, two ships passing in the night. And not really listening to each other. But when we put the two together, usually they can resolve the matter amicably. They may still disagree, but they can at least get it resolved.

CHAIRMAN MCWILLIAMS: And on your Page 7, looking at the frequently-reported areas of
concern. Can you give us the numbers? What sample size is this based on?

MR. LOWE: This is from 2017. And I did not bring the exact numbers in with me, but I can get that. I can get it to you and distribute to everybody.

MEMBER DONNELLY: Do you have, you know, without names of the resolutions, you know, how do they end up a 57 percent were examination issues? Do they trend generally that the bankers were wrong, or do they trend -- I'm trying to find out.

MR. LOWE: I'm not going to say that in here.

MEMBER DONNELLY: I threw it out that way because I didn't want to throw it the other way.

CHAIRMAN McWILLIAMS: It's only his first meeting.

MEMBER DONNELLY: Do you see that it's -- you said it was just a matter of communication.

MR. LOWE: A big part of it's often, you know, just communication. It could be a case where
the examiner did not fully again articulate how they arrived at a conclusion. Oftentimes, you know we will just crack open the manual of examination policies. Send that information. Send the definitions for some of the components. And some of the items that we look at, for instance, under the management component. And after we have that discussion, the banker will come back and say, “Oh, I completely understand.” Again, they may say they still disagree, but often times it's just, you know, providing that information.

Also sometimes, you know, we do have bankers that, you know, do just want to have a discussion at a higher level from, you know, the field level examiners. You know, often -- I know one of the bankers earlier mentioned about going up on every six months and visiting at the regional office. And that's something that we often will advocate for banks to make sure that you know who your primary points of contacts are. Have those, you know, kind of in your speed dial.

If you have a question at any point in time,
you know, you should never been inhibited or intimidated from making a call. If there's something you don't understand in the examination process or the regulatory oversight process, you know a banker should never feel intimidated to make a call, ask a question, and make sure they get an answer that they clearly understand.

CHAIRMAN MCWILLIAMS: And so, do people understand the process? And I don't mean to put either Mark or Doreen on the spot, but I might just now. If a bank, say, allows you to say okay, fine. You know, you can give the division director our name and we believe this is not going to get resolved. Then you go to Doreen or Mark and you tell them oh, there's an issue. Here's the bank and then what happens then?

MR. LOWE: Yes, I will either go to Mark or Doreen, or if it has not -- if there's no need to elevate it to that level, -- one of the regional folks may talk with one of the regional directors and say hey, this bank or their attorney has called several times. They cannot get a response with
regard to this issue, you know, why this rating, you know, came out as it was. The bank had some additional information they wanted to share before the exam was completed. Or again, it could be the application.

So at some point, either the regional ombudsman will talk with the regional director, or I'll have a discussion with either Mark or with Doreen and see if we can, you know, find out what the facts are with regard to the case.

CHAIRMAN MCWILLIAMS: Does either one of you have anything to add before Chad cuts me off? All right, thank you.

MR. LOWE: Thank you.

MR. DAVIS: I allowed four minutes for Chairman's prerogative. Thank you, Anthony.

The next panel will provide a -- will brief the committee on a forum that the FDIC held on May 7th about the use of technology in the business of banking. Doreen Eberley, the Director of the Division of --

CHAIRMAN MCWILLIAMS: Thank you.
MR. DAVIS: -- Risk Management Supervision will provide an overview of the panel discussion on emerging technologies that are transforming banking operations.

Mark Pearce, Director of the Division of Depositor and Consumer Protection, will highlight the panel discussion on the impact of emerging technologies on retail banking, including new and innovative delivery channels, enhanced customer experiences, and economic inclusion.

And Jonathan Miller is back and will provide a summary on the panel discussion about data access and balancing rights and security.

MS. EBERLEY: Okay, great. Maybe before we move into the forum panel topics, I'd like to share just a little bit of the work we've been doing at the FDIC to ensure that we're prepared to understand and address the changing landscape in financial services, and the way banks use and adapt to new technologies in our roles as bank supervisor, deposit insurer, and receiver of failed institutions. This is something that we really
have dedicated significant resources to over the last few years.

To lead these efforts, the FDIC has established an emerging technology steering committee that's co-chaired by myself and Mark Pearce. The other members of our steering committee include the most senior members of our organization, including our chief information officer and chief privacy officer, our general counsel, and the directors of the Division of Resolutions and Receiverships, Division of Insurance and Research, and Office of Complex Financial Institutions.

And then our steering committee, in turn, has established two inter-divisional working groups that consider the retail and wholesale aspects of emerging technologies in banking. Through these efforts, we're monitoring trends, opportunities, and risks in this area, and evaluating impacts on banking, general safety and soundness to deposit insurance, financial reporting, economic inclusion, and consumer
protection.

And then this work informs our supervisory strategy for responding to opportunities and risks presented by the use of emerging technologies to supervised institutions. And it really is this backdrop that led us to determine to host the forum back on May 7th.

So the forum included three panels. Each one of us moderated one of the panels. And I'll go ahead and kick off, as we spend the next few minutes describing the discussion that took place.

The first panel focused on how emerging technologies are transforming banking operations and back office functions. So, the so-called plumbing of the financial system. The panel discussed how banks can establish a strategy to support implementation of emerging technologies. And importantly, ways to ensure that security is built into the innovation as it's being developed.

The panel also discussed how banking operations can be transformed by technology such as distributed ledger technology applications and new
payment infrastructures. And then finally, the panel discussed how innovations in automation, pattern recognition, and cognitive computing are being implemented to improve operational efficiency.

The panelists included John Macaluso who is Senior Vice President of Business Development with Fiserv. Steve Ledford, Senior Vice President with The Clearing House.; Shaida Lynch, Vice President of Business Technology - Banking and Lending in support of the consumer banking organization for Discover. Dr. Victoria Adams, principal of U.S. Government programs at ConsenSys. and John Doherty who is a partner in Ernst & Young's integrated cyber risk management practice.

So, John Macaluso kicked us off, and he discussed strategies that support the entire digital experience that's required for banks to move forward in delivering good customer experiences. The takeaway from his presentation was that he encouraged banks to adopt a digital
mindset focused on demonstrating to customers that you get them, offering immediate availability of funds and services, and creating these offerings in an inspiring package, making it exciting. There was some discussion about whether it was good to be boring as banks or exciting as banks. He opted for exciting.

Steve Ledford provided an overview of the real-time payments platform, which is the first new core payments infrastructure in the U.S. in more than 40 years. He spoke of the benefits of a credit push system to minimize fraud, and described how The Clearing House wanted the real-time payments platform to really be the plumbing of the industry, and a safe foundation upon which everyone else could innovate.

Shaida Lynch shared examples of using technology to transform banking operations. She started with a prediction from Gartner that by 2020, consumers will manage 85 percent of their business relationships without interacting with humans, and she talked about what that meant for
institutions. -- that banks will need to find new ways to interact with their customers without talking to them or seeing them, using things like Business Chat. And she also spoke of the use of technology to automate backroom operations to speed customer services and the use of cognitive computing for fraud detection and prevention.

Victoria Adams, (Tori) spoke of how blockchain was first seen as something exciting and new that would disrupt banking. , but now is seen more as a product that the industry wants to adopt to improve its operations. The challenges of adoption that she discussed included the need for any kind of a blockchain to interact with legacy systems at on and off ramps to the chain.

, so she predicts that any wider adoption will have to be part of a larger digital transformation of the industry. And she opined that we're in the midst of really a significant period of transformation. And she closed with the observation that, as a rule, we over-predict the technological advances that will occur in a
one-year time horizon, but really grossly under-predict what will happen in a ten-year horizon because we just can't imagine the transformations that will take place over that timeframe.

And then our last panelist, John Doherty, discussed the need to ensure that security is built in as the innovation is being developed. He quoted a Forrester report that stated 44 percent of individuals polled don't like conducting business in an online environment because they worry about security, and that 74 percent would leave a company if they experienced a breach.

He agreed with Tori that we're in the midst of a significant period of technological change, and that the industry is going to look a lot different ten years from now.

In determining when to implement new technology, you know, are you an early adopter or a follower? The panelists spoke about the importance of focusing on the problem it was solving. -- not to adopt new technology just to
recreate or mimic an existing process, but really to solve an unsolved problem.

They also agreed that the focus of new technology adoption, right now anyhow, was focused on improving the customer experience, as opposed to achieving cost savings. Those institutions that were using it were really using it for the former purpose.

In terms of distributed ledger technology, Tori offered that a meaningful-use case will be one that starts with a problem for which distributed ledger technology may be helpful, as opposed to just a desire to use this technology to mirror an existing process on a distributed ledger.

The example she gave was, you know, somebody coming to her company and saying, you know, “I can get funding if I do this on distributed ledger technology. so I want to use this technology to fix my problem. ” as opposed to coming and saying, “I have a problem to solve. , you know, I'm looking for ways to fix this particular issue. I think distributed ledger
technology might be a piece of the puzzle.”

And then, finally, the panelists agreed that technological advances were more likely to be transformational to the industry as opposed to revolutionary, but this was going to take time. Banks will take a practical approach to incrementally meeting the needs and desires of customers and conducting business in real time.

So it really was a great panel. I'd encourage you to take a look. You can watch any of the panels or the entire daylong event on Video on Demand on our website under News and Events.

MR. PEARCE: And for the first panel, even though everyone said they talked about banking being boring, it was actually really a --

MS. EBERLEY: It was a very entertaining panel.

MR. PEARCE: -- dynamic and entertaining panel, especially on a topic of plumbing. So my panel was related to the interaction of banks with their customers. -- so more retail-focused and really looking at the potential benefits of
emerging technologies as they bring to banking and
to their customers, while considering potential
challenges and risks of implementing new
technologies.

So the panelists — we had five
panelists; Steven Antonakes who works at Eastern
Bank in Massachusetts. It's an $11 billion bank.
And Steve talked about creating an innovation lab
in the bank. They had actually acquired a firm,
brought it into the bank, and then used that group
of people to essentially digitize their application
process for small business loans.

They had seen some of the customers and
other people in the marketplace going to online
small business lenders, and they thought that they
could bring their underwriting and they had a good
ability to review loans. But providing that fast-
and- easy application process was something that
they were missing. , and so they used this
innovation lab to digitize their process and expand
their lending activity.

They then had so much success with that
and that company, then they've spun that company off. And now that company serves other banks to digitize some of their small business lending activity. And they have gone to what they called a Lab 2.0 where they're now growing a new innovation lab in their bank with homegrown employees. And so they've really invested a lot of time and energy in the technology side.

Todd Nagel who's the President and CEO of River Valley Bank, which is a $2 billion dollar bank in Wisconsin, he talked about challenges in his marketplace generating core deposits. And so they came up with an idea of having an online bank entirely online, and be able to gather deposits from a much larger geographic area. So they created a bank and they branded it Incredible Bank. This was before Incredibles 2 came out, so I don't think there was a trademark, copyright issue there. But has had great success there.

And he really described that as bringing some of the benefits of a community bank, -- the high-touch nature -- but using technology to
leverage that. and provide the same type of service, but use the technology to solve those problems and make it feel high-touch. He talked about their ability to do all of their closings that they do for some of their lending products. They can do all the closings electronically. and so the people don't have to come into the bank or send things through the mail to close the loan. And so we sort of thought that as really enhancing their relationship with their customers.

Jonathan Prendergast who is the head of the Payments Strategy Group for TD Bank talked about their bank's efforts to use technology to provide a seamless experience, no matter how their customers wanted to interact with them. So whether they wanted to come into the branch, whether they wanted to call on the phone, or go online, or use a mobile application, they talked about how they wanted to integrate all of that. So that no matter how their customer wanted to interact with them, they would be able to do as many capabilities, regardless of the channel. Discussed that being on
the channel.

He also talked a little bit about being an early adopter of Zelle peer-to-peer payments application because he really saw that as helping solve a challenge that his customers had with moving money around.

Ravi Loganathan, who is from Early Warning, was there really to just talk about Zelle and the development of Zelle. And, I think, one of the interesting things that he brought forward was that banks have the ability to customize the application in their use of Zelle so that it would have the same type of marketing and branding of the bank that was utilizing it. So that community banks and others could tailor it to make it feel like it was part of that banking, and consistent with the bank's other marketing and branding.

And then, finally, Patrick Smith from KeyBank in Ohio talked about how using technology and data together enabled them to provide insights that help them better serve their customers, particularly around financial wellness.
So Patrick talked about KeyBank's purchase of HelloWallet, which is a group that provided help for consumers to manage their financial lives and financial wellness, including use of behavioral nudges to help people promote savings and other positive activity. And he talked about, for instance, tying a savings products and the rates that the savings product paid on their loans to the customer's financial wellness score. So as the financial wellness score went up, their savings rate would go up, as well. So it provides some incentives to both help nudge the consumer to make positive financial choices and then have a defined benefit as a result of that.

There are really, from my point of view, three real key take-aways from the panel. The first is that technology is not just for big banks. -- that banks of all sizes can utilize technology. Steven Antonakes, I think, made this point the best. He said the greatest risk for community banks when it comes to implementing technology is to do nothing. That is the greatest risk. That
failure to engage in technology and utilize technology would really put community banks at a disadvantage in the marketplace.

The second is one that Doreen mentioned from her panel, which is you use technology to solve a problem -- solve a problem for your customer at least in the retail space. , and that you don't use technology for technology’s sake. That really understanding what is the use case? What does your customer need that they can't do now? What's the friction in the process?

So the online ability to apply for the small business loan that Steve Antonakes talked about was something that they used technology to solve that issue -- that particular issue -- and that the banks that were just interested in technology generally, and wanted to take it for a test drive or do something new with it, those were the ones that had the most challenges because they didn't really tie it to a business need of their customer.

And then the third point is using
technology to leverage your core competencies. So banks are good at risk management and compliance and managing their systems. And they have business strategies. And so figuring out how that technologies can really support and leverage that, the bank's core capacities, was key.

MR. MILLER: So my panel, the third panel was really about what we do with all this additional data that banks and other service providers are collecting? Who gets access to it? How do you balance rights and security?

We had three panelists: Steve Boms who was representing the Consumer Financial Data Rights Group and, you know, the big data aggregators; Rob Morgan, Vice President of Emerging Technologies at the ABA; and then Lauren Saunders from the National Consumer Law Center, representing the consumer point of view. And in light of time and the stop and seeing Chad ruling with an iron fist, I'm going to go very highly -- I'm going to go touch on the issues that we discussed at a very high level.

So the first crucial -- and let me say
that this issue is really coming up both as a result of marketplace pressures, you know, the fact that so much data is now being collected from so many different sources. And there's so much sophisticated technology to analyze and slice up that data.

And also Section 1033 of the Dodd-Frank Act, which has been broadly read to mean that consumers have a right to their financial data, including letting third parties of their choice access that financial data, including things like transaction fees, interest rates, terms of loans, and so forth.

So the first key issue is asking the question, "Who really owns the consumer's financial data? Who can get access to it and how?" The data aggregators were really of the opinion, as were the consumer -- as was the consumer representative, that it belongs to the consumers and they ought to be able to share it with third-party data aggregators. I'm thinking now of people like Mint.com and others that provide budgeting tools
and other financial management tools, -- Robo-Advisor, other things like that, -- that are third parties.

And the data aggregators see the banks as being uncooperative in their desire to get that data to serve consumers better. The ABA -- Rob Morgan from the ABA -- argued no, we're perfectly happy to share that data with the institutions, but we want to make sure that the security for that data when it leaves the bank is every bit as strong as it is when it's inside the bank. We want to make sure that there's full transparency for consumers. -- that they know who their data is being shared with, how it's being used, and with whom it's being shared, in addition to the people they permission to get it shared.

And again, I think the Facebook data sharing was sort of -- changed the discussion a little bit. Between the time we planned this and the time we actually had it, the whole controversy about the fact that people's Facebook data was being shared with people they had no clue -- that they did
not give permission to be shared with, I think is sort of one of the things that came up. We did not resolve these issues, but we did look at that.

The second big issue is liability. Who is liable in the case of banks -- or in the case of breaches or data getting out? That's obviously an enormously important issue and a point of very serious discussion. The banks are very reluctant to release data, share data if they think they're going to continue to have the liability for that. And I would say that this is -- this is an issue that's four square in front of the regulators, and has been the subject of some discussion.

Third, the role of community banks. Most of the action right now has really been between the big aggregators and the big banks. In this regard, we're very different, for example, than the EU where most of the -- most of the countries of the EU just have a few very big banks. So it's pretty easy to negotiate -- to come up with standards and have everybody buy into it because there aren't that many parties that you need to
negotiate with to reach agreement.

That's just not the case in the United States. And the consensus here was that the debate for now is really happening between the big banks and the big aggregators. And eventually it will get down to the community banks through people like Jack Henry and Fiserv and FIS and other third-party providers like that. The presumption, I think, behind a lot of this is that eventually that the community banks would want to participate in this at some point because the consumers are going to demand access to these kinds of third-party products.

And then lastly, which we just didn't get time to talk much about, but I think is sort of part of the environment that we're talking about here is the rules in the EU. So the UK initially passed an open banking rule. The EU adopted that, and it's actually requiring the banks to develop secure ways of passing along the data to third parties. But the third parties themselves have to be approved and registered and are
regulated. So it's a different model, but I think 
that's sort of -- it's called the EU Payment 
Services Directive 2 -- PSD-2 is the name of it. 
And I think that sort of serves as a little bit of 
an example for how things could go in the future.

MR. DAVIS: We still have four minutes 
for questions. Well, if nothing else, would you 
like to close us?

CHAIRMAN McWILLIAMS: Thank you, sir. I'm happy to do so. I know some people have flights 
to catch. And I know some of you came from great 
distances.

Thank you again so much for a very robust 
discussion today. And I look forward to continuing 
with the committee activities. I mentioned to some 
of you, next time we'll have an opening hour 
dedicated to you bringing us your perspectives, 
maybe with five minute presentation from everybody 
as to what you're seeing in your markets and your 
underwriting conditions and everything else that's 
happening that you can bring as a perspective to us.

And with that, I will bid you adieu and
see you in October. Thank you so much.

(Whereupon, the meeting in the above-entitled matter was concluded at 3:27 p.m.)