The Meeting of the Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

April 7, 2016 – 9:00 A.M.

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

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

Members of the FDIC Board of Directors present at the meeting were: Martin J. Gruenberg, Chairman, and Thomas M. Hoenig, Vice Chairman.

Corporation staff who attended the meeting included: Willa M. Allen, Julianne F. Breitbeil, Richard A. Brown, Susan Burhouse, Debra A. Decker, Patricia B. Devoti, Willie B. Donaldson, Doreen R. Eberley, Bret D. Edwards, Diane Ellis, Kristie K. Elmquist, Keith S. Ernst, Ralph E. Frable, Shannon N. Greco, Lawrence Gross, Jr., Barbara Hagenbaugh, Leon Hartley, Nicholas Kazmerski, Sally J. Kearney, Matthew I. Kepniss, Christopher Lucas, Roberta K. McInerney, Kathy L. Moe, Mark S. Moylan, Benjamin L. Navarro, Yazmin E. Osaki, Mark E.

Pearce, Sylvia H. Plunkett, Claude A. Rollin, Barbara A. Ryan, James P. Sheesley, Robert F. Storch, Scott D. Strockoz, James C. Watkins, Smith T. Williams, and Angela A. Wu.

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

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Chairman Gruenberg opened the meeting by welcoming the Committee members and participants. He then provided an overview of the meeting agenda, advising that first a summary of the panel presentations from the April 6, 2016 Community Banking Conference would be provided. Next, there would be an update on the Deposit Insurance Fund. Following that, in the afternoon session, staff from the Division of Depositor and Consumer Protection ("DCP") would provide a report on research in the area of mobile financial services. Finally, there would be a presentation on recent developments at Financial Accounting Standards Board ("FASB") and issues relating to the current expected credit loss proposal of FASB. Chairman Gruenberg then introduced Barbara A. Ryan, Chief of Staff and Deputy to the Chairman and Chief Operating Officer, who would be the moderator for the day's proceedings.

Ms. Ryan introduced the panelists for the first session entitled, "Reflections on the Community Banking Conference": Doreen Eberley, Director, Division of Risk Management Supervision ("RMS"), Diane Ellis, Director, Division of Insurance and Research ("DIR"), Kristie K. Elmquist, Regional Director, Dallas Regional Office and Mark S. Moylan, Deputy Director, RMS.

Ms. Elmquist provided a summary overview of her panel on the community banking model including; (1) the business model of community banks, (2) the challenges faced by community banks, and (3) the strategies community banks use to ensure success including best practices for managing risk and remaining viable. She reported that, her panel generally took the view that the community banking model remains a viable, profitable business model and is highly relevant to the financial system. Further, community banks are in a unique position to establish relationships with local customers and meet their unique needs.

Ms. Elmquist next highlighted several of the challenges her panel focused on. She explained that the first challenge the panel addressed was operating in a low interest rate environment. To deal with this challenge, two key strategies included: (1) having good modeling and monitoring to manage interest rate risk exposure, and (2) looking for ways to be efficient through controlling expenses. The second challenge involved banks competing for loans. To meet this challenge, the panel reported using a variety of different strategies, first seeking to fill credit needs outside the normal credit model, particularly with small business lending opportunities. Ms. Elmquist provided some examples discussed by her panel including; filling the credit needs for entities not necessarily equipped to be a lender or a collector, creating a new student loan program for parochial and private schools and offering government guaranteed programs such as FHA, VA, and SVA. She stated that her panel further discussed ways to help local customers, particularly small business owners, become involved in larger projects through issuing letters of credit such that they can obtain bonding to accomplish the goal. Further, she reported that her panel discussed the importance of understanding the local market and being

willing to meet the unique loan requests such as making mortgage loans on houses constructed out of unique products. Ms. Elmquist then reported that her panel discussed the challenges of banking to the next generation of customers, millennials.

Ms. Elmquist next summarized her panel's discussion concerning best banking practices including; knowing and adapting to market change, providing flexible service and providing open access to decision makers. Additionally, she reported that her panel discussed creating a culture of risk management within their employees by having them adopt and use critical thinking in making business decisions. Along these lines, Ms. Elmquist reported that her panel stressed best practices such as: (1) developing emerging leaders and involving them in the business making process, (2) encouraging employee involvement in community activities and establishing a relationship with the regulator, and (3) centralizing credit, underwriting, collection processes and recognizing the interrelationship of risks.

At this point, Ms. Elmquist opened the discussion up for comments and questions from the Committee members. There was an extended discussion on the issues raised and in general, the committee found the panel helpful, insightful and relevant to what the Committee is seeing in the marketplace. They all agreed that the panel echoed the opening statement from the Chairman that the community banking model remains relevant, viable and strong.

Ms. Ryan then introduced the next speaker, RMS Director Doreen Eberley, who provided an overview of the regulatory developments panel. Ms. Eberley reported that her panel provided insight into how the regulatory process has adapted to industry change through regulatory relief activities such as the Economic Growth and Regulatory Paperwork Reduction Act ("EGRPRA") outreach events. Ms. Eberley next outlined her panel's discussion relating to FASB, the current expected credit loss model and how it will be implemented. She talked about the importance of leveraging FinTech innovation, technology and the increased focus on cybersecurity. Ms. Eberley discussed her panel's presentation concerning risk management practices, shared services, commercial real estate, and prudent risk management for commercial real estate, including concentration risk. Ms. Eberley mentioned the post-crisis OIG evaluation that looked at institutions heavily concentrated in Acquisition, Development and Construction ("ADC") loans and commercial real estate. Ms. Eberley pointed out that the OIG evaluation found that certain of these institutions remained healthy due to better underwriting practices and focusing on market fundamentals.

Ms. Eberley next summarized her panel's discussion regarding technology service providers and the FFIEC. Specifically, she discussed the importance of ensuring the technology service provider has enough capital for research and development to prepare for cybersecurity threats and changes in rules and regulations. Finally, Ms. Eberley provided a summary of the panel discussion concerning the Current Expected Credit Loss Model ("CECL") and the Community Reinvestment Act ("CRA").

Ms. Eberley then opened the discussion up to the Committee for comments and questions following which there was an extended discussion of the issues raised by the regulatory developments panel.

Member Blankenship mentioned that it would be helpful to have a continuing dialogue of how community banks assess risk and what the appropriate risk model is based on where community banks are most vulnerable, such as cybersecurity. Member Seleski agreed and stressed the importance of staying abreast of evolving risks and working close with the regulator.

Member Bryant then asked for the number of service providers currently under examination to which Mr. Moylan answered that there are currently fifteen (15) multi-regional data processing service providers that are examined on a continuous basis. Mr. Moylan also mentioned that the service providers are rated on a one-to-three year cycle. Mr. Moylan stated that these service provider examinations are conducted on an interagency basis with the Federal Reserve and the OCC.

Vice Chairman Hoenig then asked whether the community banking industry in general, either through the ABA or the ICBA, has discussed developing their own service provider to process services. Member Blankenship responded by indicating that this is in fact one of the more common requests the ICBA receives and the challenge is individual banks becoming locked into multi-year contracts. Member Blankenship advised that the ICBA has been looking at it as a business model and from their view it might be easier to co-opt one of the major providers; one of the fundamental challenges being what type of leverage the industry really has vis-à-vis the service providers.

Member Scully offered that one reason community banks have been able to remain viable is they have been able to leverage off larger companies that have the scale and the sustainability that none of the individual community banks have. In this way, Member Scully explained, the idea of co-opting one of them is intriguing because the industry would not be trying to, in her words "reinvent the wheel." Member Tolomer mentioned that it might be too challenging for individual community banks to undergo the conversion necessary to achieve a co-opt of services. Member Lundy pointed out several other issues with servicer providers including adhesion contracts and smaller technology service companies that might have a niche product but not the balance sheet to stand behind vendor representations and warranties. In this regard, Member Lundy thought developing a database of the types of issues would be useful to the community banking industry.

Member Busse appreciated the segmentation of the findings regarding board versus management. With regard to cyber risk, the idea of due diligence, associated with mergers and acquisitions in the cyber risk area is very important and should be paramount in due diligence activity going forward. Member Busse also brought up the issue of liability with large providers. Member Busse explained that if liability is being shifted to community banks, then the regulator could assist by helping the banks ask better questions or maybe gathering the information from community banks about how that liability shift is taking place. This way, the regulator should be able to translate that into potential capital earnings risk which creates risk for the bank environment.

Ms. Ryan then introduced the next speaker, RMS Deputy Director Mark Moylan who moderated the managing technology challenges panel. Mr. Moylan began by pointing out that community banking has generally benefited from advances in technology. Mr. Moylan

addressed how, because of strong technology, innovation has increased over time and as such must be incorporated into the bank's strategic planning and due diligence involved in strategic planning. He also summarized the discussion concerning issues related to managing risk.

Mr. Moylan then opened the discussion up to comments and questions from the Committee members.

Member Castillo observed one positive aspect of technology has been the ability to utilize, through licensing, intellectual property. Member Castillo then asked whether examiners have been able to draw any conclusions relating to cloud services. Mr. Moylan responded by pointing out one of the challenges is the term "cloud" itself, which is broad and has different risk characteristics depending on what definition is being used. So, with utilization of the "cloud" it is important to understand the characteristics of the product and how it fits into the bank's risk profile. Member Williams mentioned the challenge faced by debit card fraud. In this regard, Mr. Moylan responded that customer awareness is an important facet of debit card and mobile banking services.

Ms. Ryan then introduced the next session led by DIR Director Diane Ellis, who moderated the panel on ownership structure and succession planning.

Ms. Ellis started the session by presenting an overview of an FDIC survey on the number of closely-held banks, in which significant or substantial overlap exists between ownership and management. Ms. Ellis pointed out that while there are some challenges to the closely-held form of ownership, in terms of access to capital, economies of scale, and ability to recruit, there are also some distinct advantages, namely, efficiency and performance. Ms. Ellis then discussed several of the themes covered by the panel. The first was the need by the closely-held bank to have liquid share ownership to aid in ownership and management succession; the idea being that ownership drives business decisions when shareholders need to trade shares. She next discussed the management of board succession and officer and management succession. Next, Ms. Ellis discussed commercial banking programs in universities and some of the innovative ways undergraduates are being brought into these programs to develop the next generation of bankers. In particular, Ms. Ellis summarized the points made by one of her panelists, who is a professor at Texas A&M University on the banking program offered by his institution.

Ms. Ellis then opened the panel up for comments and questions from the Committee members. Before doing so, Ms. Ellis posed two questions for discussion. The first was whether the need to liquefy shares is more or less urgent now than it has been in the past. Her second question was to ask whether or not community banks are doing an adequate job telling their story about what career paths they offer; and she invited comments and questions on the training program discussed by the panel, and in particular how a bank might utilize such a program.

Member Seleski began the discussion by pointing out that the answer to the first question depends on the bank's investor base and how impatient (or patient) they are. Member Lundy pointed out that the post-crisis period saw institutional type investors coming in thinking that they could capitalize the bank, roll up some failed or nearly failed banks, and then exit quickly. These institutional type investors then learned that the regulators were not amenable, perhaps, to

that kind of a strategy. Member Tolomer pointed out that the issue of share liquidity is always an issue for a privately held bank at some level. Member Scully reminded the group that it is important for regulators to focus on why certain community banks need capital, for instance, rural banks verses metropolitan banks. The point being that capital may become an issue more quickly for banks operating in metropolitan areas.

Member Bryant raised the issue of community banks that are either CDFIs or MDIs, when corporate organizations or nonprofit foundations made investments, and that the new leadership does not view each investment in the same manner.

Member Lundy commented on employee training and added that he endorses hiring of young people. In his institution, many new employees are hired as credit analysts. This provides the bank with a robust centralized underwriting function and becomes a resource for future development at the institution.

Chairman Gruenberg then shared some thoughts on the conference and going forward. Chairman Gruenberg mentioned there are issues that may go beyond the traditional role of supervision and it would be helpful to think about them. He observed that five years post-crisis the industry is at an inflection point; during the crisis, the industry witnessed 500 banks fail, 450 of which had assets under one billion dollars. Further, Chairman Gruenberg pointed out that of the approximately 6,200 institutions considered community banks, 93% are supervised by the FDIC. Chairman Gruenberg commented that community banks are important to the financial system and the economy, and the business model of the community bank remains highly relevant and viable. He recognized a new set of challenges to the long-term success of community banking, and mentioned the importance of building a narrative, or continuing to build a narrative, of the role of community banking in the United States, its importance to the financial system and the economy. He also discussed that, as to outreach to the market, to employees and recruitment and retention, community banks have a very positive story to tell, in terms of their service to the community, their role in the financial system in the economy, and their being an attractive and appealing place to work as well as a service to local communities. Chairman Gruenberg commented that developing this narrative in a positive way is very important. He next mentioned that it might be useful for the next meeting to have a panel of millennials to discussion how they utilize financial services.

Chairman Gruenberg noted that the educational program at Texas A&M, as discussed in the panel, might be a model that could be replicable in some additional states with other community banks. Chairman Gruenberg next mentioned that in many ways the strength of the community bank was the customer relationships, whether they are small businesses or consumers. The Chairman explained that in this way everything might be thought of in terms of building around that central issue, whether it is the communication, the recruitment, or the utilization of technology, building on utilizing technology to enhance the relationship with the customer is really fundamental. Chairman Gruenberg pointed out many bankers on the panel were reporting successful use of technology; these bankers saw the pluses of technology working in their interest. Chairman Gruenberg raised another point not mentioned in the morning panel discussion concerning the issue of new community banks and de novo banks going forward. Chairman Gruenberg suggested that it might be useful to put together a small number of

executives from successful de novo banks to talk about the experience, and what they had to do to get set up, to keep going, and their relationships with their regulator(s).

Chairman Gruenberg mentioned that it might be beneficial to have a series of work streams coming out of the conference to build on going forward. He then welcomed thoughts from the Committee members on specific items.

Ms. Ryan introduced the next session on Assessments and the Small Business Lending Survey. The presenters were DIR Director Diane Ellis, providing an update on the Deposit Insurance Fund and some rulemakings related to assessments and Smith Williams, who is Acting Chief of Special Studies Section in DIR, providing an update on a survey the FDIC is conducting on small business lending.

Ms. Ellis began with a summary update on assessments. She reported that in March, the FDIC Board approved a final rule, known as the final surcharge rule, to implement three provisions of the Dodd-Frank Act. She explained that this rule will raise the minimal reserve ratio for the DIF from 1.15 percent to 1.35 percent; this will require the agency to hit the target of 1.35 percent by September 30, 2020. She reported that the rule also requires that in setting assessments, the FDIC offset the effect of that increase on insured depository institutions with assets less than 10 billion. Ms. Ellis next stated that the final rule provides that large banks, those greater than $10 billion in assets, will pay quarterly surcharges at an annual rate of four and a half basis points in addition to their regular risk-based assessment rates which will start as soon as the reserve ratio reaches 1.15 percent; the view is that this surcharge will be enough to reach 1.35 percent in approximately eight quarters, by mid-to-late 2018. She stated that if 1.35 percent is not reached by the end of 2018, a shortfall assessment will be imposed on large banks to close the gap; the bottom line being that the DIF will reach 1.35 percent by the end of 2018.

Ms. Ellis then focused on the part of the rule providing small banks credits while the reserve ratio is being built up, which will offset the portion of their assessments that helped to actually raise the reserve ratio during this time period. She explained that one of the key ways the final rule differs from the proposed rule is after the reserve ratio hits 1.15 percent, the FDIC will automatically apply a small bank's credits to reduce its regular assessment rates. Ms. Ellis indicated that the prior proposal stated that the FDIC would not begin to apply the small bank's credits until the reserve ratio hit 1.4 percent (the thinking being that it would not be advisable to get above that 1.35 percent target and then fall down below it). She said that the effective date of the rule is when the reserve ratio reaches 1.15 percent which will then continue through the quarter the reserve that the ratio reaches or exceeds 1.35 percent. Ms. Ellis explained that the estimate is that surcharges will total about $10 billion.

Ms. Ellis reported that, as of December 31, 2015, the reserve ratio was about 1.11 percent and the DIF balance was $65.7 billion. She explained that that best estimates are that the reserve ratio should be at 1.15 percent by the first half of this year. She further explained that deposit growth was strong in the fourth quarter and this remains the variable going forward.

Ms. Ellis next spoke about small bank pricing. She mentioned that the first notice of proposed rulemaking ("NPR") was in June of 2015 (discussed at the previous Community

Banking Committee meeting) and since that time the FDIC has issued another proposed rulemaking. She explained that the new proposal was based upon a probability of failure model, which will project failures over a three year period and would update the financial ratios based upon that model. She stated that the FDIC received approximately 484 comments on this proposal. Before going to a final rule, certain of these comments needed to be addressed. Ms. Ellis explained that in February of this year, the Board approved a revised NPR that made changes to the original proposal, including using a brokered deposit ratio in place of the previously proposed core deposit ratio and treating reciprocal deposits as they are treated under the current rules. This, Ms. Ellis pointed out, was the subject of the majority of the 484 comment letters received. She reported that the second area of change was to revise the asset growth measure. Ms. Ellis explained that in the revised proposal, there is an asset growth measure that will only kick in when annual growth exceeds ten percent.

Ms. Ellis mentioned that the FDIC received 19 comment letters in response to the revised NPR; now that the comment period has closed, FDIC staff is in the process of considering the comments and developing a final recommendation, hoping to bring the final rule to the Board in the near future.

At this point Ms. Ellis then opened the discussion up to the Committee for comments and questions. Member Hartings began by asking about the accounting treatment of the credit and whether this has been addressed. Pat Mitchell, Deputy Director for Risk Analysis and Pricing in DIR, answered by opining that they would not be treated as assets. Member Menon then asked for elaboration on the issue relating to C&I loans. Ms. Ellis responded by discussing the loan mix index. Ms. Ellis explained that the loan mix index looks at categories of loans reported on the Call Reports, and charges more for loans where there was a very high charge off rate during periods of high bank failures. She went on to state that the loan mix index charges more for construction and development loans than it would for C&I loans, then it would for C&I secured by real estate, consumer, agricultural lending, and so on. Ms. Ellis explained that the intent was for it to be a risk-based system.

Member Scully voiced concern regarding the proportion of safety and soundness examination percentages versus the risk-based formula. Her point being that there might be dilution of whatever was done in a safety and soundness exam. Ms. Ellis responded by reminding that CAMELS ratings are only one of the eight factors utilized and it is a weighted average CAMELS rating and then seven financial ratios. Ms. Ellis clarified that the current system buckets banks first by their CAMELS ratings so that in this way, one and two-rated banks are in a separate category than three, four, and five-rated banks. Ms. Ellis pointed out that the FDIC is eliminating the buckets so going forward, the formula is going to apply to all banks.

Ms. Ellis then introduced the next presenter, Acting Chief of Special Studies Smith Williams. Ms. Smith began by stating that she and her colleagues have been working on developing a unique survey of banks on their small business lending activities. She stated that the survey is designed to answer some fundamental questions concerning small business lending, which is vital to the community banking sector. Ms. Smith explained that the raw Call Report data does not contain the information or granularity to answer some fundamental questions about how small business lending needs are being met. The main purpose of the survey, she said, is to

help fill data gaps. Ms. Williams reported that the survey will be launched this summer and will be conducted through the U.S. Census Bureau. Ms. Williams indicated that the process began back in 2014 and involved developing a list of questions for the banks. In 2015, her group received input and feedback from the banking community. She explained that the feedback was incorporated into the survey which made it shorter and also that multiple versions were developed, the intent being to make it more answerable. She further explained that the version of the survey a bank receives depends on the bank's size and core data systems. Ms. Williams reported that some survey topics include the characteristics of small business borrowers, the size of small business lending originations, and the size of outstanding loans by collateral (provided the bank's core data systems are able to report this data). Ms. Williams stated that the survey also seeks information on loan products and underwriting, and how underwriting of small business loans is done at banks. Finally, she indicated there is a small section in the survey that inquires about consumer transaction accounts, which is due to a congressionally-mandated obligation.

Ms. Williams next indicated that the survey intends to answer questions such as how banks meet the needs of the small business community, how important small business lending is to a bank's portfolios and how banks of various sizes differ in characteristics of small businesses that they serve, the products that they offer to small businesses, and the obstacles they face in serving the small business community. She reported that the survey is set to go out this summer and only to a nationally representative random sample of banks. Ms. Williams concluded by saying that hopefully the survey will provide new insight into bank small business lending and also further demonstrate the important role that small business lending plays in the U.S. economy.

Member Hartings asked for clarification on the length of the survey and how many data points or questions. Ms. Williams responded by stating that answer is difficult to quantify because depending on how the questions are answered, there may be follow up questions. This being said, Ms. Williams stated that the response time should not exceed 2-3 hours for small banks and up to 6 hours for large banks. Member Hartings then asked who at the bank should fill out the survey. Ms. Williams responded by stating that the survey provides a list of suggested personnel to help fill out the survey which mainly are senior commercial loan officers and loan operations staff.

At this point, the meeting broke for lunch at 12:06 p.m.

The meeting reconvened at 1:18 p.m. at which time Associate DCP Director Keith Ernst began the next session regarding mobile financial services ("MFS") which centered on qualitative research that DCP has performed regarding MFS for underbanked customers. Mr. Ernst began by pointing out that the FDIC has focused on opportunities to expand economic inclusion in the banking system. He indicated that past survey work has shown that almost 1 in 12 households or 16.6 million adults, have no access to the banking system whatsoever. Mr. Ernst stated that research has shown the potential for mobile banking to reach the under-served and expand economic inclusion. Further, he said, survey results demonstrate that mobile and smartphones are accessible to under-served populations and that many under-banked households are already using mobile banking. He brought up statistics from the 2013 survey that

demonstrate these points: (1) 91 percent of under-banked households had a mobile phone. This rate is higher than the rate among fully-banked households, but the fully-banked were more likely to have smartphones; and (2) 29 percent of under-banked households reported using mobile banking, versus 23 percent of fully-banked households. He added that a majority of under-banked households using mobile banking identified it as their primary banking channel.

Based on these results Mr. Ernst indicated that a white paper was developed in 2014 to explore how technology could assist with the establishment of banking relationships and make those relationships more sustainable. Mr. Ernst stated that while the work producing the white paper was suggestive, the goal was to test the ideas by engaging consumers directly.

Mr. Ernst then introduced two primary researchers, Susan Burhouse, Senior Financial Economist, DCP, and Yazmin E. Osaki, Financial Analyst, DCP. Mr. Ernst stated that one of the key takeaways from the research is the finding that under-served consumers see MFS as positioned to address areas where they've struggled in banking relationships by, for example, enhancing their sense of control for their account.

Ms. Osaki presented highlights from the qualitative research study. Ms. Osaki made mention that the qualitative research study validates many of the takeaways from the 2014 white paper and provides a more in-depth and nuanced understanding of what the under-served consumer values when selecting financial services and how they perceive MFS in relation to these values.

Ms. Osaki then explained the methodology centered on focus groups, which were extremely informative because they gave a chance to hear directly from consumers in their own words. She indicated that there were 18 focus groups last summer with a total of 172 participants in three cities, Memphis, Los Angeles, and Kansas City. Ms. Osaki further stated that four focus groups were conducted in Spanish, and the rest in English and the focus groups targeted both unbanked and under-banked individuals. Finally, she reported that all of the participants in the survey owned smartphones.

Ms. Osaki explained that the first step in thinking about how MFS might meet under-served consumers' needs and help financial institutions appeal to these consumers was identifying and understanding their core financial service needs. She reported that across the 18 focus groups, certain core financial needs emerged. She said that the core needs include the need for control, security, and long-term partnership. Ms. Osaki stated that the focus groups revealed that consumers have a need to feel that they are in control of their finances. She further defined “control” as knowing exactly when and how money is being deposited and withdrawn from the consumer’s account and having the ability to change cash flows as desired. She also added that the ability of the consumer to keep a record of transactions that can be later accessed whenever disputes arise helps bolster that sense of control. Most importantly, Ms. Osaki stated that to feel in control, consumers need to be confident that transactions are processed timely and that unpredictable fees do not undermine their ability to keep an accurate record of their available funds. Ms. Osaki summed up by stating that predictability and transparency are highly valued by these consumers to achieve a sense of control.

Ms. Osaki next discussed the core need of security. She identified "security" as a broad term that consumers use to describe the protection of not only their funds, but also their private information. She also reported other core needs such as quick access to money, convenience, affordability, and customer service. She stated that consumers were clear about requiring quick access to their money to successfully manage the timing of incoming and outgoing payments. Ms. Osaki explained that convenience could refer to the location of the financial providers, the hours of operation, the ease or the speed of the service, or for others the ability to just access their information quickly. She mentioned that good customer service or support involves the ability to access live support when consumers need assistance through a preferred channel that is convenient to them at the time. Ms. Osaki mentioned that in thinking about economic inclusion it is also important to understand what type of financial instruments like cash, money orders, prepaid cards, the under-served consumers are using and how do these different methods meet their core financial needs.

Ms. Osaki pointed out that even with the digital financial instruments available, cash remains a key method many under-served consumers use for the day-to-day financial transactions since cash transactions are instantly settled at the time of payment although consumers did note that cash is often not accepted for rent payments and it is impossible to use in the online marketplace.

Ms. Osaki then discussed checks. Under-served consumers indicated that personal payroll checks are increasingly less common now that debit cards and direct deposits are more widespread. However, she stated that many under-served consumers are still using checks to pay bills and make payments.

Ms. Osaki next discussed the use of peer-to-peer payment tools, or P to P tools offered by banks, wire services, or other companies. She reported that some consumers in the research used these payment methods, but not the majority by any means. She stated that those who did use it were generally satisfied with these services and stressed the quick access of funds that they get.

Ms. Osaki concluded the presentation by stating the study results show that under-served consumers use a variety of financial products, they get these products from a number of different sources, and they use providers based on how well they perceive these providers helping meet the core financial needs of the moment.

Ms. Osaki then introduced Ms. Burhouse to discuss how MFS might align with the core financial needs just discussed.

Ms. Burhouse began by making the observation that awareness about MFS was generally high with consumers in the focus groups. The focus groups identified different ways consumers were learning about MFS such as directly from their financial providers or word of mouth. Ms. Burhouse then discussed how some of the specific MFS features and functions meet the needs of the consumer. Ms. Burhouse stated that consumers found it valuable to be able to access information on demand when they need it. Ms. Burhouse mentioned that consumers generally expect to see their accounts updated immediately, in real time, exactly when their transactions

occur. Ms. Burhouse also indicated that the focus groups reported positive feedback from utilizing mobile alerts; these alerts help the consumer feel more aware of his or her account status and monitor for unauthorized transactions such as fraud alerts whenever the provider noticed suspicious activity. She also indicated that these types of alerts help address the consumer's perceived need for security. Ms. Burhouse reported that consumers were receiving alerts through texts and from emails; many of the consumers indicated that they were fond of text notices, feeling that they were more immediate and attention grabbing but also saw the advantage of email which can provide more detailed information and a better way to document account history.

Ms. Burhouse mentioned certain consumers reported concerns about the alerts; some found the alerts to be at times annoying or overwhelming. She said these consumers mentioned that text alerts may not always be useful such as when they are not in a position to take action on the alert. She also mentioned that while consumers saw value in getting these types of alerts, they did not want these channels used for other purposes and they were not interested in receiving marketing or other types of unsolicited communications from the provider in these types of alerts. Ms. Burhouse pointed out that the consumer's distaste for receiving other types of alerts from the provider might be something to consider from the standpoint that if consumers are relying heavily on alerts as a primary way of getting communications from their banks they might not have opportunities to learn about other bank products and from the bank's perspective, it may be more difficult to cross-sell and grow the banking relationship.

Ms. Burhouse pointed out that some of the consumers were using MFS to pay bills with their phones. She said that the use of mobile bill pay was not as widespread as the use of the account monitoring tools but the focus group participants who were doing it were really satisfied. She reported that the consumers enjoyed the convenience of being able to take care of their bills whenever and wherever they needed to. Further Ms. Burhouse stated that certain of the consumers not using mobile bill pay found it difficult to see the value in it; some had a system that was working for them so they did not really see a reason to switch over to the mobile; others were wary of the automated nature of bill pay just in general. She said these consumers wanted to have the control to be able to stop or prioritize payments if they did not have enough money to cover everything. She added that other consumers were concerned about timing when it came to using the bank's mobile payment tools.

Ms. Burhouse next discussed the use of mobile remote deposit capture ("mRDC") which allows consumers to deposit checks by taking a picture on their phone and sending it to their institution. Ms. Burhouse reported that there were a number of vendors or consumers aware of this feature but relatively few had experience using it; although they saw convenience, they had questions and reservations about how it would work, they were concerned about the time it would take for the transaction to process and for the funds to be made available to them. She added that the users who had experience using mRDC provided mixed reports. Further, she pointed out, to some extent mRDC was being held to an even higher bar than other deposit channels. Ms. Burhouse reported that because of the electronic and digital nature of mRDC, consumers expected the transaction to happen instantly even if they would not necessarily expect an ATM deposit or other type of deposit to be available that quickly. Ms. Burhouse stated that consumers also had questions about the security of mRDC; they did not necessarily trust the

technology and that it was prone to fraud. She added that these types of concerns were an obstacle for some consumers. Finally, Ms. Burhouse indicated that other consumers mentioned that mRDC really did not carry value for them because they rarely received paper checks; if they were already receiving the direct deposit to their bank account or even a prepaid card then they really did not feel like they had a need to use the remote deposit capture.

Ms. Burhouse then mentioned the final MFS function, namely, mobile account opening. She explained that the hypothesis being that the ability to open an account on a mobile phone, while potentially challenging for financial institutions, could be an effective tool for improving access to accounts, especially among consumers whose only access to the Internet is through their phone. She reported that the focus group research did not reveal the lack of a computer to be a huge hurdle to account opening; simply put, the focus group participants did not demonstrate a large demand for mobile account opening. In this way, she explained that it was perceived to be a convenient way to open an account but consumers had reservations; the concerns involving account security. Finally, Ms. Burhouse stated that the focus group participants voiced a strong and clear desire for personal interaction at account opening.

Ms. Burhouse then concluded by stating that the data collected is being used to learn whether and how MFS can improve a bank's ability to meet under-served consumers' core needs. She reported that one area where banks are already perceived to be doing very well is in personal financial management, long-term planning; under-served consumers felt that banks are good partners, better than nonbank providers for long-term financial relationships. She also indicated that banks are perceived to be strong over MFS in the areas of security and customer service.

Ms. Burhouse reported that in terms of customer service, consumers did have positive perceptions of banks, especially relative to prepaid card providers and consumers felt that banks' staffs were generally more interested in helping them resolve issues than nonbanks and they really valued the ability to reach a live person when they needed, either at the branch or on the phone. MFS, however, was not seen as a good means to meet this type of need. Ms. Burhouse summarized by stating that, according to the focus group study, banks are highly regarded for their security and customer service and consumers perceive MFS to be inferior in these areas.

Ms. Burhouse also pointed out that under-served consumers perceived banks to be weakest in terms of access to money and consumers expressed frustration about delays in check clearing and incoming payments; these issues are somewhat dependent on individual banks but they are also dependent on a merchant's policies and even more broadly on the payment systems and their technologies and limitations. She explained that while MFS might give fast access to information the mobile channel itself does not directly impact how quickly these transactions are clearing or when consumers will actually have access to the funds themselves. Ms. Burhouse stated that control, convenience and affordability are perhaps the most interesting; these are areas where consumers do not view traditional banking doing well but felt that MFS is strong.

Ms. Burhouse stressed that under-served consumers tend to feel out of control when they lack a say in their bank account about when transactions will hit. She indicated that they are adverse to the uncertainty about knowing when payments will be posted. In this regard, the under-served consumers find it inconvenient to be tied to the specific bank branch locations and

hours and many of them have had a bad experience with bank fees. So, Ms. Burhouse reasoned, areas such as control, convenience and affordability, are areas where MFS can help. For instance, she reasoned that alerts can help consumers feel in control, MFS can help them keep records, keep track of expenses and balances allowing for more informed decisions about spending, MFS can help avoid overdraft and other fees and as banking becomes more available it will lead to more sustainable and better banking relationships. Finally, Ms. Burhouse said banks, financial educators and other stakeholders can help consumers understand what features are available and how MFS can help meet their needs.

In conclusion, Ms. Burhouse stated that the research has provided valuable insight into the under-served consumers' financial needs and how these drive their decision-making. Consumers felt that their essential needs were control, convenience and affordability. These needs were not being well addressed by traditional banks but could be served by mobile banking. Ms. Burhouse indicated that mobile banking is not a stand-alone solution for economic inclusion. She also added that MFS does not appeal to everyone. Now that the qualitative research has been completed, Ms. Burhouse stated that they are working on releasing a final report which will come out next month and staff will be presenting and discussing that report at the Chairman's Advisory Committee on Economic Inclusion in May.

Mr. Moylan then rounded out the discussion with a summary of FFIEC activities relating to IT. He reported that some of the specific risks associated with four types of mobile financial service technologies are: short message services or texting, mobile enabled websites, mobile applications and wireless payment technologies. Then, he stated, wireless payment technologies break down into additional categories including; near-field communications, image-based, area-based and also mobile payment person-to-person. The FFIEC guidance will address strategic operational, compliance and reputational risk, provide guidance on risk identification, risk measurement, risk mitigation, monitoring and reporting for each type. For instance, Mr. Moylan said, texting has a different risk profile than P to P, and web-based has a different profile than mobile. In summary, Mr. Moylan stated that the FFIEC guidance will help define these characteristics and hopefully it will be approved soon.

Following these presentations, there was a general discussion among the Committee members concerning the issues raised by the panel.

Chairman Gruenberg then observed that the issues presented in the case study have been prominent in terms of trying to find vehicles to give consumers access to the banking system versus alternative providers that may be more expensive; even though the product may be more convenient, provide a broader range of services and be less expensive, it still may have trouble competing with the alternative in part because the alternative has an established trust relationship. Chairman Gruenberg mentioned this as an important insight because the importance of the relationship can be equal to the convenience and savings of the technology; if the relationship cannot be established then it really becomes an issue. Chairman Gruenberg then pointed out that local community organizations that have a trust relationship may have an interest in having their members find lower cost and better services in the financial arena.

Next Ms. Ryan introduced the final session concerning recent developments at the FASB including new work on the CECL model. Making the presentation was FDIC Chief Accountant, Bob Storch from the Division of Risk Management Supervision.

Mr. Storch began by explaining that FASB has been on a multi-year process working with the international accounting standards board to move from the incurred loss model to the CECL model. Mr. Storch stated that CECL is meant to be a workable standard for all types and sizes of institutions and banks should be able to build on existing systems and processes that are in place.

Mr. Storch next discussed the timetable. For companies that are designated as SEC filers, the standard would take effect in the first quarter of 2019. For other organizations that are deemed to be public from an accounting definition standpoint, the standard would take effect in the beginning of 2020. Private institutions would implement the standard as of year-end 2020, although the transition adjustment would have to be measured as of the beginning of 2020 but would not have to be booked until year-end.

Mr. Storch next discussed the current status of the standard. Mr. Storch reported that the FASB recently had a meeting of their Transition Resource Group. The purpose of this meeting was to review the current draft and assess whether it is clear, whether there are other areas that need to be clarified and whether the draft seemed workable. The general sense of the comments made during the meeting was that the draft was much improved.

Mr. Storch then mentioned advice the FDIC has been trying to provide, both to examiners and banks, which is to start planning now for the transition as opposed to waiting until 2019 or 2020. Mr. Storch opined that, while this will be a pervasive change for the industry, planning for the process over the next few years should ease the burden of implementing it and ultimately improve the bank’s financial reporting.

Mr. Stroch stated that one significant question is how large of an impact the new standard will have has on a bank's financial statements. Mr. Storch pointed out that there is really no good answer at this point because every bank has its own portfolio with its own underwriting standards. Further, it is unclear what the economic conditions will be in 2019 or 2020. There is no benchmark percentage of increase that the banking agencies expect all banks to have their allowance go up "X" percent. Rather, it will be institution specific. It will depend on the bank’s loan portfolio. Next, Mr. Storch addressed questions and comments from the Committee. Member Haskins asked about the time frame for the historical look back. Mr. Storch responded by stating that there is no clear-cut answer. Mr. Storch further stated that it may depend on the life of the loan so if, for example, there are loans that have an average life of 10 years, then the bank could probably look at data covering 10 years. Mr. Storch cautioned that some loan data processing systems purge data after a couple of years. So, he said, it may be challenging to get 10 years' worth of data in an automated fashion.

Member Haskin then asked about loan pools based on Call Report information and whether or not that would be a reliable source of information for the 10-year look back. Mr. Storch responded by stating that yes, there would be 10 years' worth of data available. The

challenge would be that while there would be losses for each of the 10 years, the lifetime loss rate for a loan with a 10-year life is not 10 times the annual loss rate. Since portfolios are constantly changing and the level of the loans in that type of loan category is increasing, it will be a challenge to determine how the bank might be able to look at the last 10 years and translate the losses each of the years into a lifetime loss rate.

Mr. Storch commented that the data issue is a key area of interest and he would like to see continued discussion with trade groups to try to work on viable methods that will be available to the community institutions to come up with estimates. Member Haskin then commented that she would appreciate FDIC consideration of that because it's something that could be fairly easy obtained by looking back at the Call Report information.

Member Williams then asked about how much the reserve requirement is going to change. Member Williams commented that there appears to be a consensus that reserves are going up which makes the process appear to be a means to an end. Mr. Storch responded by stating that it is very much extending the model that is being used today. The input will be the historical lifetime experience rather than annualized experience – yielding a loss rate and adding on the forward looking or reasonable supportable forecast feature to go beyond the current conditions. But the rest of the basic framework still would be able to be applied. Member Williams then indicated that he was concerned about what is going to be acceptable as the forward look. Mr. Storch responded that a reference point might be the Federal Reserve website and the forecasting done at the district level and sometimes down to the state level. Mr. Storch then went on to state that certain types of assumptions about forward-looking conditions used for other business purposes already in the bank should be analogous to loan portfolio impact as well.

Member Blankenship then asked whether there will be acceptable benchmarks, standards that the agencies would be willing to accept such as those from the Federal Reserve. Mr. Storch responded by stating that there has been discussion across the agencies that when the standard comes out there would be some information to share with the industry about at least initial types of expectations for the standard, in part to eliminate any confusion, misunderstanding or misinformation there may be about the standard. Further, Mr. Storch reminded that the FDIC has existing policy statements and under the old accounting model, there is a 2006 interagency policy statement on the allowance and there is one from 2001 on methodologies and documentation. These would be updated. Further, the FDIC is going to provide education and training to examination staff. Chairman Gruenberg then asked about the likely timeframe for the final action by FASB. Mr. Storch responded by stating that the timeline for final action by the FASB is mid-2016.

Member Blankenship commented that the unknown may create issues for banks and have an effect on mergers, curtail expansion activity, cause leveraging activities, prevent banks from taking advantage of opportunities, result in their erring on the side of caution.

Ms. Ryan then turned the discussion back over to Chairman Gruenberg.

Chairman Gruenberg then commented that he felt that the comments and discussion were very helpful and that there will be more discussion on these topics going forward. Chairman Gruenberg then thanked the presenters and the Committee.

There being no further business, the meeting was adjourned at 3:04 p.m.

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

Minutes

of the

Meeting of the FDIC Advisory Committee on Community Banking

of the

Federal Deposit Insurance Corporation

Held in the Board Room

Federal Deposit Insurance Corporation Building

Washington, D.C.

Open to Public Observation

April 7, 2016 – 9:00 A.M.

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

Martin J. Gruenberg

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